WHO'S MINDING YOUR PENSION?

HEARING

BEFORE THE

SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

OF THE

SELECT COMMITTEE ON AGING
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

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CONTENTS

MEMBERS OPENING STATEMENTS

Page

Chairman William J. Hughes ... 1
Thomas J. Tauke ... 3
Jerry F. Costello ... 5

CHRONOLOGICAL LIST OF WITNESSES

Raymond Maria, Acting Inspector General, U.S. Department of Labor ... 6
David George Ball, Assistant Secretary for Pension and Welfare Benefits, U.S. Department of Labor ... 40
Paul A. Friedman, attorney, DeMaria, Ellis & Hunt, Newark, NJ ... 96
Donald V. Holland, Assistant Director of the Administrative Law Section, Georgia Insurance Department, Atlanta, Georgia ... 110
Andrew J. Capelli, Chairman, Employee Benefit Plans Committee, American Institute for Certified Public Accountants ... 122
Thomas C. Walker, President and Chief Executive Officer, Associated Benefits Corporation ... 133

APPENDIX

Appendix 1. "Changes Are Needed In The ERISA Audit Process To Increase Protections For Employee Benefit Plan Participants," submitted for the record by Raymond Maria ... 157
Appendix 2. Form 5500's submitted for the hearing record by Donald V. Holland ... 209
Appendix 3. Additional material received for the record:
    Supplemental material submitted for the record by Chairman Hughes ... 262
    Howard C. Weizmann, Executive Director, Association of Private Pension and Welfare Plans, Washington, DC, letter and prepared statement ... 283
    Patricia Ruth Donovan Petersen, Deputy Insurance Commissioner, State of Washington, prepared statement and letter with attachments ... 286

WHO'S MINDING YOUR PENSION?

WEDNESDAY, NOVEMBER 15, 1989

U.S. House of Representatives,
Select Committee on Aging,
Subcommittee on Retirement Income and Employment,
Washington, DC

The subcommittee met, pursuant to notice, at 9:10 a.m., in Room 311 Cannon House Office Building, Hon. William J. Hughes (chairman of the subcommittee) presiding.

Members present: Representatives Hughes, Tauke, Fawell, Ridge, James, and Stearns.

Staff present: Brian Lutz, Staff Director; Amy Melnick, Research Assistant; Ann O'Donnell, Minority Legislative Assistant.

OPENING STATEMENT OF CHAIRMAN WILLIAM J. HUGHES

Mr. Hughes. The Subcommittee on Retirement Income and Employment of the House Select Committee on Aging will come to order.

Good morning and welcome to the subcommittee's second hearing on the subject of pensions and the potential for pension reform. Presently more than 76 million workers and retirees are covered by over 870,000 private pension plans and 5 million benefit plans. The purpose of today's hearing is to examine how well these plans, which total some $1.7 trillion, are protected from fraud, corruption, abuse, and mismanagement.

Today's testimony will focus on the findings of a new report released this week by the Inspector General's Office of the U.S. Department of Labor entitled: "Changes are Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants." This report concludes that much greater enforcement provisions are essential if we are to adequately protect the Nation's pension plan assets from fraud and abuse. We will also receive recommendations from a variety of expert witnesses on whether additional safeguards and enforcement strategies would likely be more effective for ensuring that the retirement benefits which our workers and retirees have earned are not illegally siphoned off.

Since 1974, the Employee Retirement Income Security Act—ERISA—has served as the basis for protecting most private pension and welfare benefit plans from fraud and corruption. ERISA establishes participation, funding, investment and reporting standards. The U.S. Department of Labor—DOL—has primary enforcement responsibility for the protection of employee benefit rights. With DOL, the Pension and Welfare Benefits Administration—PWBA—

is responsible for ERISA investigative and enforcement activities. I am greatly concerned, however, that the standards set by ERISA are not being enforced as well as Congress intended when it passed this important legislation.

While most private pension money is well managed, both the Inspector General's report and information gathered by my Subcommittee on Retirement Income and Employment indicate that there are a number of serious problems and deficiencies with the present enforcement process.

One of the biggest deficiencies is that the great number of plans which need to be monitored creates large gaps in investigative oversight. With more than 870,000 private pension plans and in excess of 5 million fringe benefit plans in existence today, there are only about 260 investigators within the Labor Department who are responsible for investigating potential ERISA violations. Consequently, far fewer than 1 percent of the plans come under scrutiny; and in most instances, an investigation by DOL only seems to be triggered if someone persistently brings potential irregularities to their attention.

In addition, the least amount of investigative attention seems to go to the plans which are most vulnerable to abuse—the smaller pension and welfare benefit plans. These plans are often not reviewed by outside auditors and do not face the same types of layers of oversight as do plans in larger corporations.

A second important problem is that it takes up to 27 months for the forms and audit reports which pension plan administrators must submit to the Department of Labor and the Internal Revenue Service to be available for review. This very long delay makes it extremely difficult for the law to be enforced and for corrective action to be taken. In addition, many of these forms are often returned with incomplete information, making it virtually impossible to detect and prevent problems and abuses.

Another major flaw in the enforcement process is that the system relies to some extent on plan administrators at least partially reporting their own violations. Independent Public Accountant auditors are not required to directly report violations they find in the pension plans to the PWBA, which is responsible for enforcing ERISA provisions. Rather, the auditors report their findings to the plan administrators who, in turn, are often supposed to report violations of their own activities.

A fourth problem is that the current enforcement strategy consists of relying almost exclusively on civil rather than criminal penalties. I question whether fines are a significant enough deterrent to stop these types of fraudulent activities. In many cases, fines are simply considered a cost of doing business. To some unscrupulous individuals, it may seem well worth the risk, particularly considering the large pool of money which is available in the various pension and welfare plans and the low odds of being investigated by the Department of Labor.

A fifth major problem is that the limited scope of the pension audits allows a significant amount of plan assets to escape scrutiny for ERISA violations altogether. For instance, if a plan's assets are held in a bank or similar institution, the plan administrator may elect to have information certified by an institution which is not subjected to the audit. While banks and similar institutions are regulated by other Federal agencies, these audits do not usually consider whether the pension plan assets comply with ERISA requirements. In addition, the banks' reports are not available to outside plan auditors, the Department of Labor, or other interested parties. This lack of access to records and information increases the risk that mismanagement and abuse may go undetected.

In sum, I do not believe the public should panic that the private pension system is about to collapse due to extensive fraud and mismanagement. However, ignoring a situation where such large sums of money are subjected to so few effective outside investigations, combined with the minor penalties which are often imposed for those who have misused funds, seems to me to be asking for trouble.

It is my sincere hope that the testimony we hear today will help provide the basis for reasonable and productive debate on how to improve the safeguards needed to adequately protect the Nation's private pension fund assets. Our workers and retirees have a right to expect that the pensions which they have worked so hard to earn, and which they are counting on to meet basic living expenses during their retirement years, are not eroded away by waste, fraud, and corruption.

I would like to commend the Acting Inspector General from the Department of Labor, Mr. Ray Maria, for helping to bring this issue to the attention of the Congress and for suggesting a range of recommendations which can serve as a basis for debate. I believe the Inspector General's report represents an important warning that the Congress needs to discuss and enact ERISA enforcement improvements before we are forced to take more expensive steps in the future to correct costly pension abuses.

We are fortunate to have with us today a number of expert witnesses who can provide the committee with specific recommendations which the Congress will likely want to carefully consider. I would like to particularly welcome Mr. Paul Friedman, an attorney from my home State of New Jersey. Mr. Friedman successfully represented a group of hotel and restaurant employees in a case against a pension fund trustee and a former bank manager who were convicted of embezzling money from the union's pension funds. He will describe how a variety of schemes cost the plan over $1.4 million in assets and threatened the retirement security of approximately 300 members and their families.

I thank all of you very much for taking the time to appear before the Retirement Income Subcommittee today. The Chair now recognizes the ranking Republican, the gentleman from Iowa.

STATEMENT OF REPRESENTATIVE THOMAS J. TAUKE

Mr. TAUKE. Thank you, Mr. Chairman. I commend you for convening this important hearing of the subcommittee on an issue that could impact the retirement income security of the American work force. Since enactment of the Employee Retirement Income Security Act of 1974—ERISA—the voluntary private pension system has flourished. We have witnessed significant growth in the breadth of coverage of the American work force, as well as increased financial security in private pension plans. In fact, plan assets have more than quadrupled since the enactment of ERISA. Beneficiaries are confident that the promise of retirement benefits will be kept. ERISA is working.

Our primary concern today is whether or not ERISA adequately deters the potential misuse of pension funds. We will be hearing testimony from various experts on our private pension system. Specifically, we will examine the findings of a recent report of the Department of Labor's Office of Inspector General which indicates that there may be some problems in the enforcement of ERISA.

The Inspector General reports that there may be widespread fraud in the administration and disposition of pension plans. While certainly we should be concerned about it, it occurred to me that some of the publicity connected with this report has not been helpful.

Certainly the headlines that have been appearing in some of the Nation's papers suggesting that the pension system is broken are causing senior citizens across the Nation to be concerned, and that is not helpful to our investigations this morning.

I am hopeful, therefore, that during our hearing this morning, we will keep in mind that our private pension system is not broken. The purpose of this hearing is to ensure the integrity of private pension plans. On the one hand, I am deeply distressed by the findings of the Inspector General's report. On the other, I am assured by the fact that almost 70 million American workers are covered by private pension plans and will receive benefits totaling approximately $1.7 trillion.

I think people should remain confident. While we may find abuses occur, we should not condemn the system. As I indicated earlier, ERISA is working.

Mr. HUGHES. Do any Members have a statement that they would like to submit for the record?

Mr. JAMES. We are most concerned about the problems that I have heard about with pension funds investment rules, as well as fraud. I am concerned that the rules and regulations, if we change them concerning not only big pensions but small pensions for small companies.

Mr. FAWELL. I have no statement.

Mr. HUGHES. At this time I would like to submit the prepared statement of the Honorable Jerry Costello, a member of this subcommittee who is unable to be with us this morning. Hearing no objections, so ordered.

[The prepared statement of Representative Costello follows:]

OPENING STATEMENT BY
U.S. CONGRESSMAN JERRY F. COSTELLO
NOVEMBER 14, 1989
Who's Minding Your Pension?

Many of my Older Constituents have recently contacted me to express their concerns with abuses to private pension benefit plans, so I would like to take this opportunity to thank you, Mr. Chairman, for today's timely hearing.

The understandable fear of losing a private pensions that took many years to obtain is too great a burden to place on our Senior Citizens, in light of the many other difficult problems that they face. I feel that this fear alone is reason enough for the Subcommittee on Retirement Income and Employment to address this issue today.

I look forward to studying the Inspector General's report on this issue as well as reviewing today's testimony and I would like to thank today's witnesses for appearing here today.

Mr. Hughes. We are fortunate to have with us today a number of distinguished witnesses who can provide the subcommittee with an overview of the issues and suggest some recommendations for improving pension safeguards. We are short on time this morning due to an 11 o'clock joint session of Congress.

First, we receive the report and testimony of the Acting Inspector General Raymond Maria and then move to David Ball, Assistant Secretary of the Pension and Welfare Benefits Administration. Following that, we will move to the questioning of both witnesses.

I would like to welcome Mr. Maria, who has served as Acting Inspector General for Department of Labor since 1984. In this capacity, he assists the Inspector General in planning and auditing department-wide programs. He served as special agent for the BFI where he concentrated on organized crime and labor racketeering. He is a member of the American Institute of CPAs.

We are also fortunate to have with us this morning Mr. David Ball, the newly appointed Assistant Secretary for the Pension Welfare Benefits Administration. Let us offer our most sincere congratulations.

I think you have been on board since mid-October, so you are relatively new. Mr. Ball comes to us following a very, very successful stint in the private sector as the chief operating officer of the AMEX Corporation. I thank you for being with us today.

Mr. Ball is accompanied by Alan Lebowitz, Deputy Assistant Secretary for Program Operations, and Ms. Ann Combs, Deputy Assistant Secretary of Policy for Labor.

Mr. Maria, your statement will be made a part of the record without objection. We hope you can summarize it for us. We have read your testimony, and it will be part of the record in full. If you can summarize, that will enable us to get right to questions.

STATEMENT OF RAYMOND MARIA, ACTING INSPECTOR GENERAL, U.S. DEPARTMENT OF LABOR

Mr. Maria. Thank you, Mr. Chairman, and members of the subcommittee. You have asked me to testify and discuss the enforcement of private pension plans. My remarks today will be equally applicable today to private welfare plans, as well.

The welfare plans which deliver a variety of services are generally more vulnerable to fraud and abuse than pension plans. The failure of the DOL to maintain a strong enforcement strategy, in our view, has created a window of opportunity for those who would embezzle and steal from participants.

There are two reasons. First, the department has not adequately conceptualized and defined the role of the independent public accountant who is in a prime position to provide relevant up-to-date information for civilian and criminal enforcement purposes. Two, the department unduly emphasizes civil and administrative remedies at the expense of criminal remedies. Criminal enforcement is not a panacea; however, it must be judiciously factored into any equation.

When the Office of Inspector General attempted to use its expertise to fill this criminal enforcement gap in even a limited fashion, DOG officials obtained an opinion from the Department of Justice restricting the investigative authority of OIG's Office of Investigations.

Earlier this year, OIG made a comparison between the vulnerabilities which we believe exist in employee benefit plans and the continuing savings and loan crisis, a comparison which resulted in some harsh criticism. Initially, I emphasize that our comparison involves what we perceive to be a potential crisis in the benefit plan field, rather than a current crisis.

Secondly, I reiterate that our office views its role as something more than purely reactive, something more than following up on investigative leads and tips, something more than reviewing the activities of DOL's various program agencies. The Inspector General Act of 1978 clearly directs us to prevent and detect fraud and abuse in department programs and operations. It is easy to catalog abuses in an historical fashion and regale this subcommittee and others with charts and statistics regarding our accomplishments. We are not content to travel down this easy path.

We view our role as increasingly preventive, encompassing an obligation to alert the Congress, the Department of Labor, and the public about vulnerabilities and risks which we perceive in DOL programs and operations, vulnerabilities which will be exploited unless appropriate steps are taken. In this role, we are not always armed with the degree of uncontroverted empirical evidence which we would use in a specific audit or in a criminal trial. We are making informed judgments based upon our expertise and experience. Specifically, we based our benefit plans/savings and loan comparison upon our audit work in the pension and welfare plan field, and upon the investigative work conducted by our Office of Investigations prior to the DOG opinion and by our Office of Labor Racketeering, which has always had, and continues to have, criminal jurisdiction over employee benefit plans where racketeering may be present. We stand by this comparison and the warning it was intended to convey.

Our goal is not to unnecessarily frighten people but to stimulate concern where such concern is needed, and to avoid potential future crises. I do not want to be in the future position nor do I want my successors to be in the position of standing before you and saying, "I told you so." Unfortunately, our efforts with regard to employee benefit plans have almost always been met with resistance from the Department of Labor, which appears to defer more to the voices of industry rather than the voices of plan participants.

The Employee Retirement Income Security Act of 1974—ERISA—was enacted to provide protections to American workers. Its most important provisions with regard to enforcement include: Extensive reporting and disclosure requirements imposed upon plan administrators; standards of conduct for fiduciaries in managing and investing plan assets; designation of the Secretary of Labor to act on behalf of plan participants and to administer and enforce the fiduciary standards, prohibited transaction rules, and reporting requirements; and a requirement that plan administrators engage an Independent Public Accountant—IPA—to annually audit those plans with more than 100 participants.

Mr. Chairman, it is imperative that the work of the IPAs be better integrated into the overall ERISA reporting, disclosure, and enforcement efforts. All enforcement efforts, whether they be civil, administrative, or criminal require relevant, accurate, and up-to-date information. IPA reports can, if focused and utilized properly, provide this sort of information.

Based upon a 1984 OIG audit, a Department of Labor task force recognized that IPAs were a private sector resource with enormous potential to immediately enhance the enforcement of ERISA. This task force recommended that: IPAs should design audit procedures to detect irregularities suggestive of transactions prohibited by ERISA; IPAs should report violations directly to DOL; and sanctions should be imposed against accountants who perform substandard examinations.

Following DOL's failure to adequately address these recommendations, OIG initiated a review of 168 IPA reports to determine if they were useful in monitoring plan compliance with the civil and criminal provisions related to ERISA. These 168 reports encompassed plans in which investigations by OIG's Office of Labor Racketeering and DOL's Pension and Welfare Benefits Administration—PWBA—had documented criminal and civil violations dealing with the misuse of plan assets. OIG focused on 62 reports concerning those plans with the most egregious violations. In a December, 1987 audit report, OIG found it was impractical to use IPA reports in their current form to monitor plan compliance.In April of this year, OIG issued an audit report on the ERISA disclosure process. Under ERISA, the Secretary of Labor has the responsibility to provide a mechanism by which plan participants can obtain information about their plan. Access to such information would give the participants recourse to action themselves or through the Secretary, if warranted.

OIG found that plan participants are not provided adequate information in a timely manner from PWBA. Some participants waited for more than a year for a response to their requests for information and when they did receive information, many advised us that it was useless to them.

Further, the most current data provided by PWBA to participants who requested it in fiscal year 1988 was for plan years ending in 1984, and most of the data was for plan years ending in 1983. We concluded that PWBA is not complying with the requirements of ERISA and has not implemented its public disclosure responsibility efficiently or effectively.

This week, OIG has issued another audit report based upon a review of 279 IPA reports randomly selected through statistically valid sampling methods. The report is aptly entitled, "Changes are Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants."

The findings in this report reinforce our previous findings and echo that little, if anything, has been done to improve Independent Public Accountant reporting since OIG's 1984 audit report: Current limited scope audits do not adequately test transactions or plan assets. IPA audits do not consistently meet professional standards, and PWBA is not enforcing existing ERISA requirements that these standards be met; and IPA audits are not disclosing information to plan participants or rendering opinions on information accompanying a plan's financial statement as required by ERISA.

We found that IPA reports often do not give a fair opinion of the financial state of these plans because ERISA allows a plan administrator to omit from audit review any assets held in trust in a government-regulated industry such as a bank or savings and loan institution. This is commonly referred to as a "limited scope review."

The legislative intent of this provision was based upon the assumption that such institutions already were subject to regular audits by Federal and State agencies and that examination of benefit plan assets held in trust would be duplicative.

However, OIG audit work has disclosed that audits of these government-regulated institutions are sporadic at best, precluding a continuous verification of plan assets or continuous assurance that these assets are being managed in compliance with ERISA. Clearly, government regulation of an industry does not necessarily ensure that invested plan assets are, in fact, protected.

When the assets of a plan excluded from the IPA's audit review under the limited scope exemption are material to the financial statements, the IPA report is nothing more than a disclaimer of opinion, giving no assurance of asset integrity.

When a disclaimer is imminent on the financial statements taken as a whole, very little testing is done in our areas typically vulnerable to abuse, such as benefit payments, administrative costs, sponsor contributions, and service providers. It is important to realize that a disclaimer is synonymous with no opinion at all. What comfort does a "no opinion" audit report give to a participant?

We found that almost half of the IPA audits reviewed—127 our of 279—had the scope limitation which allows plan administrators to tell the auditors to skip the testing of assets held in trust by banks. As a result, $4.2 billion out of the $9.8 billion in plan assets in our audit universe—43 percent—were never audited by the IPAs. This is an unacceptable percentage if we are interested in asset integrity.

By reviewing audit work papers, we found that 23 percent of the IPA audits—64 out of 279—did not meet one or more the Generally Accepted Auditing Standards—GAAS), despite ERISA requirements to do so. We found that 65 percent of the IPA reports—181 our of 279—did not meet ERISA or DOL requirements regarding required disclosures or required audit opinions on information accompanying a plan's financial statements. For example, required schedules of matters such as transactions with parties-in-interest, assets held for investment, and reportable transactions, are often not included in IPA reports. Consequently, plan participants are not receiving the information or protections of full disclosure as Congress intended.

ERISA specifies that it is DOL's responsibility to oversee plans on behalf of the participants and ensure that their interests are protected. However, under current IPA reporting procedures, neither the department nor the participants are directly informed of potential ERISA violations.

IPAs today consider plan sponsors or administrators to be their clients, and their reports are addressed to these parties. The plan administrator is then responsible for submitting the audit report and other financial statements as part of the plan's annual filing with the Internal Revenue Service. This process is untimely, since it takes about 2 years for the information to reach the Department of Labor and unwieldy, since PWBA does not have the resources to carefully review all annual reports.

Further, this process contains a basic flaw since it essentially asks plan administrators to report their own violations. Potential ERISA violations uncovered by IPAs, we strongly believe, should be directly reported to the Department of Labor. The need to improve the use of benefit plan audits is clear, and I am pleased to inform this subcommittee that the new Assistant Secretary for Pension and Welfare Benefits, David Ball, appears to be receptive to some of OIG's recommendations.

Mr. Ball has made sure that OIG is part of consultations with the AICPA regarding new audit guidelines, and has agreed to work with OIG regarding a proposal to eliminate the limited scope exemption. These are extremely positive steps, and I am cautiously optimistic that this cooperative trend will continue.

Turning our attention to the role of criminal enforcement, within the DOL Office of Inspector General, two entities conduct criminal investigations; the Office of Labor Racketeering—OLR—and the Office of Investigations—OI). The Office of Labor Racketeering was established as part of OIG when Congress enacted the Inspector General Act of 1978.

The rationale of Congress was unequivocally clear: To ensure that organized crime and racketeering activities related to labor were investigated and prosecuted, since DOL had virtually dismantled this function. By placing this function within the independent Office of Inspector General, Congress assured that the DOL would have a viable labor racketeering function and that criminal investigations would not be subject to undue political influence by the regulated community.

Office of Labor Racketeering in its 11 years of existence compiled an impressive record of achievements, including significant indictments and conviction arising from investigations involving union-related—Taft-Hartley— employee benefit plans, and more recently, in single employer plans, plans with no union involvement whatsoever.

Through these investigations, it has become apparent that single employer benefit plans are especially susceptible to fraud and corruption. A new generation of racketeers has emerged, able and willing to rip off plan participants who are rarely, if ever, in a position to do anything about these potential losses.

I believe a recent editorial in the Los Angeles Times aptly describes this situation in the context of employers and service providers who defraud pension plan participants. The Times refers to them as "A new generation of vipers." Further, it is evident that the criminal enforcement efforts of the PWBA with regard to these single employer plans are minimal. Accordingly, in 1986 former Inspector General Hyland decided to devote some of the resources of the Office of Investigations to pursue aggressively investigations of potential fraud and corruption in these plans, pursuant to the broad statutory mandate found in the IG Act of 1978.

Notwithstanding the indictments and resulting convictions obtained through OI's efforts, this decision was met with intense resistance within the Department of Labor, and resulted in an internal solicitor's opinion stating that OI did not have the authority to conduct these and other types of investigations. In an opinion requested by DOL, the Department of Justice—in March, 1989—not only supported the solicitor's viewpoint, but placed additional restrictions upon OIG's criminal investigative authority.

This is a critical point in the Office of the Inspector General. But third party administrators, insurance executives, attorneys and accountants, nonunion people who commit the same offenses, embezzlements, kickbacks and extortion, are not to be subjected to the same type of rigorous investigation and remedies commensurate with the crime. I think what we are dealing with here is a double standard. The labor unions of America don't have an exclusive monopoly on corruption; that is crystal clear.

As a result of this opinion, the Office of Inspection has suspended many types of criminal investigations. Presumably, the burden will now fall upon the Department of Labor to specifically complete these suspended and referred investigations and to generally create an effective enforcement strategy, one which has a deterrent effect and one which results in real punishment for those who defraud benefit plan participants and recklessly endanger the health and safety of American workers.

If history serves as any guide, plan participants will receive little protection from potential fraud and corruption. The Department of Labor as an institution has minimized criminal enforcement, in the benefit plan arena and elsewhere. Despite an internal "review," which is under way, and promises of a new and improved criminal enforcement strategy from the department, OIG has significant reservations.

PWBAs criminal enforcement record is particularly lacking. In a recent 3-year period, PWBA conducted approximately 5,000 investigations, and only 95 of these were classified as criminal matters. I can only characterize this as a token effort. It is not a meaningful criminal enforcement program, and it does not create a credible deterrent for those who would defraud plan participants. Further, a legitimate question remains regarding the remaining 4900 cases classified as noncriminal matters during this 3-year period. How many of these cases contain facts and circumstances which merit criminal investigation?

PWBA has no trained criminal investigators, not enough investigators or compliance officers of any type, and there is no evidence of a commitment to enforce the criminal laws. The reporting forms filed under ERISA contribute little to effective criminal enforcement. Significant investigations of benefit plan fraud generally require tips and informants and often sophisticated investigative techniques such as electronic surveillance. PWBA has no present capability to conduct such investigations.

In order to respond to OIG's criticisms and its call for increased criminal enforcement, DOL has turned to the ERISA Advisory Council, a statutory body established to make recommendations to the department. However, recent meetings of this Council, and in particular its Enforcement Working Group, do not reflect the deliberations of a dispassionate group, but instead manifest what is wrong with the entire enforcement process within DOL.

I would urge the members of this subcommittee to review the entire transcript of the Working Group's November 1st meeting, as well as the draft report and recommendations submitted to the full Advisory Council on November 8th, recommendations which were unanimously adopted by the full Council. During the November 1st meeting of the Working Group, the chairman of the Group stated that Congress "very deliberately" decided to "emphasize civil enforcement" of ERISA. Another member of the Working Group asserted, "I still think civil enforcement is the priority and that nothing should be done to change that around." These and similar statements found in both the November 1st transcript and the draft report of the Working Group reveal a body whose uninformed views are contradicted by the express actions of Congress.

In 1984, Congress amended ERISA—in 29 U.S.C. 1136 (b)—and made clear its desire for increased criminal enforcement of ERISA. After extensive hearings on the lack of criminal enforcement of ERISA, Congress not only affirmed the authority of DOL but specifically directed the Secretary of Labor to detect, investigate, and refer appropriate civil and criminal violations. Incredibly, the Working Group stated in its draft report, "We do not believe, however, that Congress intended in this legislation to reverse the enforcement priorities established by ERISA in 1974." The language of the 1984 amendment, as well as the legislative history, belies this misdirected contention.

In its draft report, the Working Group urged the Advisory Council to recommend that "the ERISA criminal enforcement program not be expanded pending further study, debate and deliberation." However, in conjunction with this call for additional study, the Working Group also recommended that the Inspector General "not be authorized to conduct ERISA regulatory investigations, criminal or civil." Both of these recommendations were adopted unanimously by the full Advisory Council.

Mr. Chairman, OIG unequivocally disagrees with these recommendations, which are not in the best interests of plan participants and beneficiaries. In fact, they belittle and ignore their interests by recommending that the Secretary restrain criminal investigations by PWBA pending further study, and that OIG be barred from its own criminal investigation. This is a victory for the plan predators, a win for the "vipers."

I will not belabor the interpretation of the March DOJ opinion or the definition of "regulatory investigations," except to say categorically that OIG criminal investigations of Title XVIII violations of the U.S. code are not "regulatory" and do not usurp "program responsibilities." Further, I am assuming that the recommendation regarding OIG only pertains to the Office of Investigations and not to the Office of Labor Racketeering, whose jurisdiction is absolutely clear.

I will, however, respond to certain statements made by the Working Group, statements which demonstrate an appalling lack of understanding of the criminal process; statements which distort OIG's positions and function; and statements which bring into question the credibility and either the motives or the competence of this Working Group and the full Advisory Council.

In the agenda for its November 1st meeting, the Advisory Council's Enforcement Working Group raised this question: Would an enhanced criminal enforcement program interfere with an effective civil enforcement program—e.g., by discouraging voluntary cooperation for fear of prosecution, or by diverting scarce budgetary resources)? Any agenda which prejudges an issue in this fashion can only evoke the specious and biased reasoning displayed by one member of the Working Group: "The SEC is a damned good example of where problems have taken place. There is an unhealthy competition between the civil enforcement group and the criminal enforcement group."

Mr. Chairman, my reply is that the SEC is a damned good example of an aggressive criminal enforcement posture, specifically in the area of insider trading, which is achieving positive and much needed results. It is the spectre of criminal prosecution and real jail time that deters these kinds of white collar criminals.

The fines and judgments which result from civil and administrative enforcement actions are important, but they cannot stand alone. For too many businesses and too many individuals, these monetary sanctions are merely another cost of doing business. The Chairman of the Working Group finds it "extraordinary that you would have the Inspector General accountable to no one," and "making prosecutorial decisions without any guidelines." The draft report of the Working Group asks, "Who would serve as the 'watchdog' over the 'watchdog?'"

What is extraordinary, Mr. Chairman, is the gross distortion created by these statements. The Inspector General gathers facts. The Inspector General does not make any prosecutorial decisions. These decisions are made solely by Department of Justice for Federal criminal violations. The Enforcement Working Group is composed mainly of attorneys. It is my opinion that they ought to know better. Further, I believe it is an affront to this subcommittee and others within Congress. We are always accountable, as are other Federal law enforcement agencies, to Congress and its investigative arm, the General Accounting Office.

The Working Group also seems to have an overriding concern that allowing OIG to have criminal investigative authority in the employee benefit plan arena will "isolate the criminal enforcement program from the normal political processes." Perhaps this is the true concern of representatives of the pension and welfare plan industry, that they would no longer be able to influence political appointees and others within the Department of Labor's program agencies and thereby influence the scales of justice.

The Inspectors General were established by Congress precisely to avoid this sort of influence and interference. Congress wanted independent and objective units and mandated that each Inspector General be chosen without regard to political affiliation. The Chairman of the Working Group and those who agree with him are ignoring the intent of Congress and appear preoccupied in my view with being apologists for the industry at the expense of the American worker. If their advice is what the Secretary of Labor has been receiving over these years, it is no small wonder we have the problems we have in the enforcement process.

Mr. Chairman, specifically you asked that we address the enforcement of benefit plans with fewer than 100 participants. The overwhelming majority of ERISA-covered pension plans have fewer than 100 participants. Although more assets are held by plans with greater than 100 participants, the smaller plans still hold hundreds of billions of dollars in assets.

As you are aware, those plans with fewer than 100 participants are exempt from the annual reporting and audit requirements of ERISA. They have to comply with less stringent 3-year reporting requirements. Further, since most of these plans will be single employer plans, OIG's Office of Investigations in now unable to conduct criminal investigations of them pursuant to the DOJ opinion. OR, however, can still investigate those plans where elements of racketeering are suspected. Unfortunately, these are the very plans which need vigilant criminal enforcement, because these are the plans which are indeed most vulnerable to fraud and corruption. It appears that these types of plans are falling between the cracks of enforcement.

There has been a proliferation of other types of plans which fall between these enforcement cracks, for example public employee plans, which are defined as those plans established or maintained for its employees by the Federal Government or any State government or political subdivision thereof. These plans are specifically exempted from coverage under ERISA; they are also exempt from the criminal provisions of Title XVIII which pertain to employee benefit plans.

OIG's Office of Labor Racketeering has found service providers associated with these types of public sector plans who have organized crime connections, but the Federal criminal provisions related to embezzlement and kickbacks from an employee benefit plan—18 U.S.C. 664—are not applicable to these plans.

OIG has recommended—to DOL—that legislation be proposed which would expressly bring these types of plans under the coverage of this and related criminal statutes. PWBA has opposed this recommendations, stating it raises "significant policy issues which should be resolved." OIG believes the primary policy issue involved here is the protection of thousands of public employees from criminal depredations on their plans.

Recently, OIG has also become aware of problems involving fraudulent multiple employer welfare arrangements—MEWAs—which are not being addressed by PWBA. When State insurance officials have attempted to investigate possible fraud in these plans, they have encountered claims of preemption under ERISA, and the officials to whom we have spoken have uniformly decried the lack of assistance they have received from DOL.

These MEWAs masquerade as nonprofit, self-insured medical plans and solicit small to medium-sized companies and businesses seeking health care coverage for their employees. Sales solicitations generally are made by insurance salesmen at premiums which range from 20 percent to 50 percent below the prevailing market rate of legitimate trusts and insurance companies.

The sales pitch is made with full knowledge that the trusts are insolvent and cannot possibly meet their reimbursement liability. Premium revenue is dwarfed by expenses for unwanted and unneeded services, and in many instances the premium revenue vanishes through outright embezzlement by the fraud artists who administer these plans.

Unlike insurance companies, MEWAs are not licensed by State insurance regulators and generally do not maintain reserves to pay claims. With the expectation of staying afloat for a period of time through aggressive selling and slow claims payment, these fraudulent METS have become a variation of the classic Ponzi scheme. In one State alone, since mid-1988, 3,000 participants have become victims of such fraud and are now personally liable for nearly $3.2 million in medical costs they thought were insured. We are not talking about the top of the economic scale here. We are talking about people who are relying solely on this plan.

State enforcement agencies have been frustrated in their attempts to address these fraudulent MEWAs, frustrated by multi-State fraud schemes, limited resources, and historical unresponsiveness by the U.S. Department of Labor. OIG has moved vigorously to address this burgeoning corruption in welfare plans, but can effectively apply only its OLR jurisdiction to the problem as a result of the March DOJ opinion. Clearly, the public interest is not served by limiting OIG's ability to protect all plan participants from criminal exploitation.

We have some recommendations regarding our findings and observations, Mr. Chairman. They are: Congress should make clear, through legislation, the extent of criminal investigative jurisdiction for Inspectors General.

Congress should remove the limited scope exemption for IPA audits.

Congress should consider the inclusion of public sector employee benefit plans in the relevant Title XVIII criminal provisions.

Congress should study the enforcement, or lack thereof, of benefit plans with fewer than 100 participants.

The Department of Labor should require direct reporting of ERISA violations by IPAs to senior plan management and to the board of directors or its audit committee, and to PWBA.

The Department of Labor should require ERISA compliance testing and reporting by IPAs.

Finally, I would reiterate and emphasize that the use of criminal remedies with regard to fraud and corruption in employee benefit plans should be judiciously factored into the overall Department of Labor enforcement equation.

Thank you for your interest this morning. I would be pleased to answer any questions you may have.

[The prepared statement of Raymond Maria follows:]

TESTIMONY OF RAYMOND MARIA
ACTING INSPECTOR GENERAL
U.S. DEPARTMENT OF LABOR
BEFORE THE SELECT COMMITTEE ON AGING
SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT
U.S. HOUSE OF REPRESENTATIVES
NOVEMBER 15, 1989

Mr. Chairman and Members of the Subcommittee:

Thank you for your invitation to testify this morning. Although you have asked me to discuss the enforcement of private pension plans, most of my remarks will be equally applicable to private welfare plans. In fact, welfare plans are generally much more vulnerable to fraud and abuse due to the multiplicity of administrators and service providers engaged in the delivery of medical, dental, optical, legal, and insurance services.

Simply put, the enforcement of statutory and regulatory provisions pertaining to employee benefit plans is woefully inadequate and plan benefits are increasingly vulnerable to fraud and abuse. The failure of the Department of Labor to conceptualize and maintain a strong and integrated enforcement strategy has created a window of opportunity for those who would embezzle and steal from plan participants. There are two primary reasons for this failure:

1. DOL has not adequately conceptualized and defined the role of Independent Public Accountants (IPAs), who are

statutorily included in the benefit plan reporting process and are in a prime position to provide relevant and up-to-date benefit plan information for civil or criminal enforcement purposes.

2. DOL unduly emphasizes civil and administrative remedies at the expense of criminal remedies. Criminal enforcement is not a panacea; however, it must be judiciously factored into the overall equation. When the Office of Inspector General attempted to use its expertise to fill this criminal enforcement gap in even a limited fashion, DOL officials obtained an opinion from the Department of Justice restricting the investigative authority of OIG's Office of Investigations.

Earlier this year, OIG made a comparison between the vulnerabilities which we believe exist in employee benefit plans and the continuing savings and loan crisis, a comparison which resulted in some harsh criticism. Initially, I emphasize that our comparison involves what we perceive to be a potential crisis in the benefit plan field, rather than a current crisis.

Secondly, I reiterate that our office views its role as something more than purely reactive, something more than following up on investigative leads and tips, something more than reviewing the activities of DOL's various program agencies. The Inspector General Act of 1978 clearly directs us to prevent and detect fraud and abuse in Department programs and operations. It is easy to catalogue abuses in an historical fashion and regale this Subcommittee and others with charts and statistics regarding our accomplishments. We are not content to travel down this easy path.

Rather, we view our role as increasingly preventive, encompassing an obligation to alert the Congress, the Department of Labor, and the public about vulnerabilities and risks which we perceive in DOL programs and operations, vulnerabilities which will be exploited unless appropriate steps are taken. In this role, we are not always armed with the degree of uncontroverted empirical evidence which we would use in a specific audit or in a criminal trial. We are making informed judgments based upon our expertise and experience. Specifically, we based our benefit plans/savings and loan comparison upon our audit work in the pension and welfare plan field, and upon the investigative work conducted by our Office of Investigations prior to the DOJ opinion and by our Office of Labor Racketeering, which has always had, and continues to have, criminal jurisdiction over employee benefit plans where racketeering may be present. We stand by this comparison and the warning it was intended to convey.

Our goal is not to unnecessarily frighten people but to stimulate concern where such concern is needed, and to avoid potential future crises. We do not want to be in the future position of saying, "I told you so." Unfortunately, our efforts with regard to employee benefit plans have almost always been met with resistance from the Department of Labor, which appears to defer more to the voices of industry rather than the voices of plan participants.

Role of IPAs in the Enforcement of Employee Benefit Plans

The Employee Retirement Income Security Act of 1974 (ERISA) was enacted to provide protections to American workers. Its most important provisions with regard to enforcement include:

-- Extensive reporting and disclosure requirements imposed upon plan administrators;

-- Standards of conduct for fiduciaries in managing and investing plan assets;

-- Designation of the Secretary of Labor to act on behalf of plan participants and to administer and enforce the fiduciary standards, prohibited transaction rules, and reporting requirements; and

-- A requirement that plan administrators engage an Independent Public Accountant (IPA) to annually audit those plans with more than 100 participants.

Mr. Chairman, it is imperative that the work of the IPAs be better integrated into the overall ERISA reporting, disclosure, and enforcement efforts. All enforcement efforts, whether they be civil, administrative, or criminal, require relevant, accurate, and up-to-date information. IPA reports can, if focused and utilized properly, provide this sort of information.

Based upon a 1984 OIG audit, a Department of Labor task force recognized that IPAs were a private sector resource with enormous potential to immediately enhance the enforcement of

ERISA. This task force recommended that:

-- IPAs should design audit procedures to detect irregularities suggestive of transactions prohibited by ERISA;

-- IPAs should report violations directly to DOL; and

-- Sanctions should be imposed against accountants who perform substandard examinations.

Following DOL's failure to adequately address these recommendations, OIG initiated a review of 168 IPA reports to determine if they were useful in monitoring plan compliance with the civil and criminal provisions related to ERISA. These 168 reports encompassed plans in which investigations by OIG's Office of Labor Racketeering and DOL's Pension and Welfare Benefits Administration (PWBA) had documented criminal and civil violations dealing with the misuse of plan assets. OIG focused on 62 reports concerning those plans with the most egregious violations. In a December, 1987 audit report, OIG found it was impractical to use IPA reports in their current form to monitor plan compliance because:

-- American Institute of Certified Public Accountants (AICPA) audit and reporting guidelines neither encourage IPAs to detect nor to inform PWBA of potential ERISA violations;

-- IPAs who perform plan audits have little incentive to identify or report ERISA violations;

-- The quality of IPA reports needs improvement; and

-- IPA reports are not received on a timely basis.

Additionally, we found in our 1987 audit report that plan participants, on whose behalf these audits are conducted, are not routinely informed about errors, irregularities, and illegal acts by plan administrators or others. IPAs consider the plan administrator as their only client, thus denying the Secretary of Labor, and ultimately the particpants, critical information.

In April of this year, OIG issued an audit report on the ERISA disclosure process. Under ERISA, the Secretary of Labor has the responsibility to provide a mechanism by which plan participants can obtain information about their plan. Access to such information would give the participants recourse to action themselves or through the Secretary if warranted.

OIG found that plan participants are not provided adequate information in a timely manner from PWBA. Some participants waited for more than a year for a response to their requests for information and when they did receive information, many advised us that it was useless to them. Further, the most current data provided by PWBA to participants who requested it in fiscal year 1988 was for plan years ending in 1984, and much of the data was for plan years ending in 1983. We concluded that PWBA is not complying with the requirements of ERISA and has not implemented its public disclosure responsibility efficiently or effectively.

This week, OIG has issued another audit report based upon a review of 279 IPA reports randomly selected through statistically valid sampling methods. The report is aptly entitled, "Changes are Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants." In essence, the findings in this report reinforce our previous findings and echo that little, if anything, has been done to improve IPA reporting since OIG's 1984 audit report:

-- Current limited scope audits do not adequately test transactions or plan assets;

-- IPA audits do not consistently meet professional standards and PWBA is not enforcing existing ERISA requirements that these standards be met; and

-- IPA audits are not disclosing information to plan participants or rendering opinions on information accompanying a plan's financial statement as required by ERISA.

We found that IPA reports often do not give a fair opinion of the financial state of these plans because ERISA allows a plan administrator to omit from audit review any assets held in trust in a government-regulated industry such as a bank or savings and loan institution. This is commonly referred to as a "limited scope review." The legislative intent of this provision was based upon the assumption that such institutions already were subject to regular audits by federal or state agencies and that examination of benefit plan assets held in trust would be duplicative. However, OIG audit work has disclosed that audits of these government-regulated institutions are sporadic at best, precluding a continuous verification of plan assets or continuous assurance that these assets are being managed in compliance with ERISA. Clearly, government regulation of an industry does not necessarily ensure that invested plan assets are, in fact, protected.

When the assets of a plan excluded from the IPA's audit review under the limited scope exemption are material to the financial statements, the IPA report is nothing more than a disclaimer of opinion, giving no assurance of asset integrity. When a disclaimer is imminent on the financial statements taken as a whole, very little testing is done in other areas typically vulnerable to abuse, such as benefit payments, administrative costs, sponsor constributions, and service providers. It is important to realize that a disclaimer is synonomous with no opinion at all. What comfort does a "no opinion" audit report give to a participant?

We found that almost half of the IPA audits reviewed (127 out of 279) had the scope limitation which allows plan administrators to tell the auditors to skip the testing of assets held in trust by banks and other regulated financial institutions. As a result, $4.2 billion out of the $9.8 billion in plan assets in our audit universe (43%) were never audited by the IPAs. This is an unacceptable percentage.

By reviewing audit workpapers, we found that 23% of the IPA audits (64 out of 279) did not meet one or more the Generally Accepted Auditing Standards (GAAS), despite ERISA requirements to do so. This result is caused, in part, by a lack of monitoring and feedback by PWBA, which results in a low priority given to ERISA audits by IPAs. Generally, a benefit plan is audited only because it is required under ERISA, and it is done as part of the audit of the sponsor's overall financial statements. Most plan audits which we reviewed were completed in fewer than 40 hours. This appears to be an extremely short time for a complete GAAS audit including the coverage required by ERISA.

We found that 65% of the IPA reports (181 out of 279) did not meet ERISA or DOL requirements regarding required disclosures or required audit opinions on information accompanying a plan's financial statements. For example, required schedules of matters such as transactions with parties-in-interest, assets held for investment, and reportable transactions, are often not included in IPA reports. Consequently, plan participants are not receiving the information or protections of full disclosure as Congress intended.

ERISA specifies that it is DOL's responsibility to oversee plans on behalf of the participants and ensure that their interests are protected. However, under current IPA reporting procedures, neither the Department nor the participants are directly informed of potential ERISA violations. IPAs consider plan sponsors or administrators to be their clients, and their reports are addressed to these parties. The plan administrator is then responsible for submitting the audit report and other financial statements as part of the plan's annual filing with the Internal Revenue Service.

This process is untimely, since it takes about two years for the information to reach PWBA, and unwieldy, since PWBA does not have the resources to carefully review all annual reports. Further, this process contains a basic flaw since it essentially asks plan administrators to report their own violations. Potential ERISA violations uncovered by IPAs should be directly reported to the Department of Labor.

The need to improve the use of benefit plan audits is clear, and I am pleased to inform this Subcommittee that the new Assistant Secretary for Pension and Welfare Benefits, David Ball, appears to be receptive to some of OIG's recommendations. Mr. Ball has made sure that OIG is part of consultations with the AICPA regarding new audit guidelines, and has agreed to work with OIG regarding a proposal to eliminate the limited scope exemption. These are positive steps and I am cautiously optimistic that this cooperative trend will continue.

Role of Criminal Enforcement

Within the DOL Office of Inspector General, two entities conduct criminal investigations, the Office of Labor Racketeering (OLR) and the Office of Investigations (OI). The Office of Labor Racketeering was established as part of OIG when Congress enacted the Inspector General Act of 1978. The rationale of Congress was crystal clear: to ensure that organized crime and racketeering activities related to labor were investigated and prosecuted, since DOL had virtually dismantled this function. By placing this function within the independent Office of Inspector General, Congress assured that the Department of Labor would have a viable labor racketeering function and that criminal investigations would not be subject to undue political influence by the regulated community.

OLR has, in its eleven years of existence, compiled an impressive record of achievements, including significant indictments and convictions arising from investigations involving union-related (Taft-Hartley) employee benefit plans, and more recently, in single employer plans. Through these investigations, it has become apparent that single employer benefit plans are especially susceptible to fraud and corruption. A new generation of racketeers has emerged, able and willing to rip off plan participants who are rarely, if ever, in a position to do anything about these potential losses. I believe a recent editorial in the Los Angeles Times aptly describes this situation in the context of employers and service providers who defraud pension plan participants: we have a "new generation of vipers."

Further, it is evident that the criminal enforcement efforts of the PWBA with regard to these single employer plans are minimal. Accordingly, in 1986 former Inspector General Hyland decided to devote some of the resources of the Office of Investigations to pursue aggressively investigations of potential fraud and corruption in these plans, pursuant to the broad statutory mandate found in the IG Act of 1978.

Despite the indictments and resulting convictions obtained through OI's efforts, this decision was met with intense resistance within the Department of Labor, and resulted in an internal Solicitor's opinion stating that OI did not have the authority to conduct these, and other types, of investigations. In an opinion requested by DOL, the Department of Justice (in March, 1989) not only supported the Solicitor's viewpoint, but placed additional restrictions upon OIG's criminal investigative authority.

As a result, OI has suspended many types of criminal investigations, including several single employer benefit plan investigations. Presumably, the burden will now fall upon the Department of Labor to specifically complete these suspended and referred investigations and to generally create an effective enforcement strategy, one which has a deterrent effect and one which results in real punishment for those who defraud benefit plan participants and recklessly endanger the health and safety of American workers.

Unfortunately, if history serves as any guide, plan participants will receive little protection from potential fraud and corruption. The Department of Labor as an institution has minimized criminal enforcement, in the benefit plan arena and elsewhere. Despite an internal "review" which is under way and promises of a new and improved criminal enforcement strategy from the Department, OIG has significant reservations.

PWBA's criminal enforcement record is particularly lacking. In a recent three year period, PWBA conducted approximately 5000 investigations, and only 95 of these were classified as criminal matters. I can only characterize this as a token effort. It is not a meaningful criminal enforcement program, and it does not create a credible deterrent for those who would defraud plan participants. Further, a legitimate question remains regarding the remaining 4900 cases classified as non-criminal matters during this three year period. How many of these cases contain facts and circumstances which merit criminal investigation?

PWBA has no trained criminal investigators, not enough investigators or compliance officers of any type, and there is no evidence of a commitment to enforce the criminal laws. The reporting forms filed under ERISA contribute little to effective criminal enforcement. Significant investigations of benefit plan fraud generally require tips and informants and often sophisticated investigative techniques such as electronic surveillance. PWBA has no present capability to conduct such investigations.

In order to respond to OIG's criticisms and its call for increased criminal enforcement, DOL has turned to the ERISA Advisory Council, a statutory body established to make recommendations to the Department. However, recent meetings of this Council, and in particular its Enforcement Working Group, do not reflect the deliberations of a dispassionate group, but instead manifest what is wrong with the entire enforcement process within DOL. I would urge the Members of this Subcommittee to review the entire transcript of the Working Group's November 1st meeting, as well as the draft report and recommendations submitted to the full Advisory Council on November 8th -- recommendations which were unanimously adopted by the full Council.

During the November 1st meeting of the Working Group, the Chairman of the Group stated that Congress "very deliberately" decided to "emphasize civil enforcement" of ERISA. Another member of the Working Group asserted, "I still think civil enforcement is the priority and that nothing should be done to change that around." These and similar statements found in both the November 1st transcript and the draft report of the Working Group reveal a body whose uninformed views are contradicted by the express actions of Congress.

In 1984, Congress amended ERISA (in 29 U.S.C. 1136(b)) and made clear its desire for increased criminal enforcement of ERISA. After extensive hearings on the lack of criminal enforcement of ERISA, Congress not only affirmed the authority of DOL but specifically directed the Secretary of Labor to detect, investigate, and refer appropriate civil and criminal violations. Incredibly, the Working Group stated in its draft report, "We do not believe, however, that Congress intended in this legislation to reverse the enforcement priorities established by ERISA in 1974." The language of the 1984 amendment, as well as the legislative history, belies this contention. For example, in a letter written to the Department of Justice following the enactment of this amendment, six of the chief Senate sponsors of this bill stated:

> Our intent .... was to clearly authorize and encourage an aggressive investigative effort by the Labor Department against corruption and criminal activity in all areas of labor-management relations including, but not limited to, both union and employee benefit plan activity.

In its draft report, the Working Group urged the Advisory Council to recommend that "the ERISA criminal enforcement program not be expanded pending further study, debate and deliberation." However, in conjunction with this call for additional study, the Working Group also recommended that the Inspector General "not be authorized to conduct ERISA regulatory investigations, criminal or civil." Both of these recommendations were adopted unanimously by the full Advisory Council.

Mr. Chairman, OIG unequivocably disagrees with these recommendations, which are not in the best interests of plan participants and beneficiaries. In fact, they belittle and ignore their interests by recommending that the Secretary restrain criminal investigations by PWBA pending further study, and that OIG be barred from its own criminal investigations. This is a victory for the plan predators -- a win for the "vipers."

I will not belabor the interpretation of the March DOJ opinion or the definition of "regulatory investigations," except to say categorically that OIG criminal investigations of Title 18 violations are not "regulatory" and do not usurp "program responsibilities." Further, I am assuming that the recommendation regarding OIG only pertains to the Office of Investigations and not to the Office of Labor Racketeering, whose jurisdiction is absolutely clear. I will, however, respond to certain statements made by the Working Group -- statements which demonstrate an appalling lack of understanding of the criminal process; statements which distort OIG's positions and function, and; statements which bring into question the credibility and either the motives or the competence of this Working Group and the full Advisory Council.

In the agenda for its November 1st meeting, the Advisory Council's Enforcement Working Group raised this question:

> Would an enhanced criminal enforcement program interfere with an effective civil enforcement program (e.g., by discouraging voluntary cooperation for fear of prosecution, or by diverting scarce budgetary resources)?

Any agenda which prejudges an issue in this fashion can only evoke the specious and biased reasoning displayed by one member of the Working Group: "The SEC is a damned good example of where problems have taken place. There's an unhealthy competition between the civil enforcement group and the criminal enforcement group."

Mr. Chairman, my reply is that the SEC is a damned good example of an aggressive criminal enforcement posture, specifically in the area of insider trading, which is achieving positive and needed results. It is the spectre of criminal prosecution and real jail time that deters these kinds of white collar criminals. The fines and judgments which result from civil and administrative enforcement actions are important, but they cannot stand alone. For too many businesses and individuals, these monetary sanctions are merely another cost of doing business.

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Further, I believe it is an affront to this Subcommittee and others within Congress to assert that the IGs are accountable to no one. We are always accountable, as are other federal law enforcement agencies, to Congress and its investigative arm, the General Accounting Office.

The Working Group also seems to have an overriding concern that allowing OIG to have criminal investigative authority in the employee benefit plan arena will "isolate the criminal enforcement program from the normal political processes." Perhaps this is the true concern of representatives of the pension and welfare plan industry, that they would no longer be able to influence political appointees and others within the Department of Labor's program agencies and thereby influence the scales of justice.

The Inspectors General were established by Congress precisely to avoid this sort of influence and interference. Congress wanted independent and objective units and mandated that each Inspector General be chosen without regard to political affiliation. The Chairman of the Working Group and those who agree with him are ignoring the intent of Congress and appear preoccupied with being apologists for the industry at the expense of the American worker.

"Let me try and make one statement that's very short and sweet," said one Working Group member. "If there's going to be enhanced criminal functions for ERISA, the one thing, damned sure, is the IG should not be handling it." I would suggest that the ERISA Advisory Council, and the Department of Labor, show a greater concern for plan participants, instead of worrying about using their influence on Capitol Hill to prevent IG agents from carrying weapons or executing search warrants, instead of denigrating the Office of Inspector General as a "little police department," and instead of spending its time figuring out ways to dismantle and/or criticize OIG.

Other Enforcement Considerations

Mr. Chairman, your invitation letter asked that my testimony also address the enforcement of plans with fewer than 100 participants. The overwhelming majority of ERISA-covered pension plans have fewer than 100 participants. Although more assets are held by plans with greater than 100 participants, the smaller plans still hold hundreds of billions of dollars in assets.

As you are aware, those plans with fewer than 100 participants are exempt from the annual reporting and audit requirements of ERISA. They have to comply with less stringent three year reporting requirements. Further, since most of these plans will be single employer plans, OIG's Office of Investigations is now unable to conduct criminal investigations of them pursuant to the DOJ opinion. OLR, however, can still investigate those plans where elements of racketeering are suspected. Unfortunately, these are the very plans which need vigilant criminal enforcement, because these are the plans which are are indeed most vulnerable to fraud and corruption. It appears that these types of plans are falling between the cracks of enforcement.

There has been a proliferation of other types of plans which fall between these enforcement cracks, for example public employee plans, which are defined as those plans established or maintained for its employees by the Federal Government or any state government or political subdivision thereof. These plans are specifically exempted from coverage under ERISA; they are also exempt from the criminal provisions of Title 18 which pertain to employee benefit plans.

OIG's Office of Labor Racketeering has found service providers associated with these types of plans who have organized crime connections, but the federal criminal provisions related to embezzlement from an employee benefit plan (18 U.S.C. 664) are not applicable to these plans. OIG has recommended (to DOL) that legislation be proposed which would expressly bring these types of plans under the coverage of this and related criminal statutes. PWBA has opposed this recommendation, stating it raises "significant policy issues which should be resolved." OIG believes the primary policy issue involved here is the protection of thousands of public employees from criminal depredations on their plans.

Recently, OIG has also become aware of problems involving fraudulent multiple employer welfare arrangements (MEWAs) which are not being addressed by PWBA. When state insurance officials have attempted to investigate possible fraud in these plans, they have encountered claims of preemption under ERISA, and the officials to whom we have spoken have uniformly decried the lack of assistance they have received from DOL.

These MEWAs masquerade as non-profit, self-insured medical plans and solicit small to medium-sized companies and businesses seeking health care coverage for their employees. Sales solicitations generally are made by insurance salesmen at premiums which range from 20% to 50% below the prevailing market rate of legitimate trusts and insurance companies. The sales pitch is made with full knowledge that the trusts are insolvent and cannot possibly meet their reimbursement liability. Premium revenue is dwarfed by expenses for unwanted and unneeded services, and in many instances the premium revenue vanishes through outright embezzlement by the fraud artists who administer these plans.

Unlike insurance companies, MEWAs are not licensed by state insurance regulators and generally do not maintain reserves to pay claims. With the expectation of staying afloat for a period of time through aggressive selling and slow claims payment, these fraudulent METS have become a variation of the clasic Ponzi scheme. In one state alone, since mid-1988, 3000 participants have become victims of such fraud and are now personally liable for nearly $3.2 million in medical costs they thought were insured.

State enforcement agencies have been frustrated in their attempts to address these fraudulent MEWAs -- frustrated by multi-state fraud schemes, limited resources, and historical unresponsiveness by the U.S. Department of Labor. OIG has moved vigorously to address this burgeoning corruption in welfare plans, but can effectively apply only its OLR jurisidiction to the problem as a result of the March DOJ opinion. Clearly, the public interest is not served by limiting OIG's ability to protect all plan participants from criminal exploitation.

Recommendations

OIG submits the following recommendations concerning the enforcement of pension plans and welfare plans:

1. Congress should make clear, through legislation, the extent of criminal investigative jurisdiction for Inspectors General

2. Congress should remove the limited scope exemption for IPA audits.

3. Congress should consider the inclusion of public sector employee benefit plans in the relevant Title 18 criminal provisions.

4. Congress should study the enforcement, or lack thereof, of benefit plans with fewer than 100 participants.

5. The Department of Labor should require direct reporting of ERISA violations by IPAs to senior plan management and to the board of directors or its audit committee, and to PWBA.

6. The Department of Labor should require ERISA compliance testing and reporting by IPAs.

Finally, I would reiterate and emphasize that the use of criminal remedies with regard to fraud and corruption in employee benefit plans should be judiciously factored into the overall Department of Labor enforcement equation.

Thank you for your interest this morning. I would be pleased to answer any questions you may have.

[See Appendix 1, p. 157 for report submitted by Mr. Maria.]

Mr. HUGHES. I thank you, Mr. Maria. I am not sure how much you summarized for me. I am going to ask you, Mr. Ball, if you would attempt to summarize. I realize that is very, very difficult to do.

Welcome to the subcommittee. Your statement will be made a part of the record in full without objection. Please try to summarize for us.

STATEMENT OF DAVID GEORGE BALL, ASSISTANT SECRETARY FOR PENSION AND WELFARE BENEFITS, U.S. DEPARTMENT OF LABOR

Mr. BALL. Thank you, Mr. Chairman. I will try to be as brief as possible. This is my first appearance before Congress as an Assistant Secretary of Labor. I am honored to appear before this particular committee which has had a long and distinguished record of safeguarding our retirees' interest.

I can think of no subject matter more deserving of this subcommittee's attention than the security of our Nation's pension funds. The strength and stability of our private pension system is vitally important to our workers and retirees. The strong and effective enforcement of our pension laws is a top priority for the Secretary and for me.

First, I would like to take this opportunity to reassure the Nation's workers and retirees that the pension system is fundamentally sound. Furthermore, the vast majority of plans in the U.S. are operated responsibly. Recent reports from our Inspector General and the press have questioned the safety and integrity of the pension system. We welcome this scrutiny and agree that we must be vigilant to protect workers' retirement savings. However, Secretary Dole and I are concerned that people may misunderstand and become alarmed about the security of their pension benefits.

The pension system has, by any objective measure, never been healthier. In 1974 only 35 percent of defined benefit pension plans were fully funded. In 1988, 80 percent of these plans are fully funded. The assets of pension plans have grown from under $290 billion in 1974 to $1.7 trillion today. In the aggregate, defined benefit pension plans are overfunded by approximately $200 billion. Retirees receiving benefits from pension plans have increased from 4.8 million in 1975 to 9 million today and are expected to grow to 13 million in the year 2000.

Historically, plans that were terminated with insufficient assets, got that way because they were systematically underfunded, not because of fraud or abuse. Both ERISA minimum funding rules and the tax rules were substantially strengthened in 1987 to assure that plan participants and the government's pension insurance program would not be harmed due to underfunding of pension plans. I can assure you that the department is committed to preserving a healthy pension system for our country's workers.

We are proud of the results which we have achieved in enforcing the provisions of ERISA. In the last 5 years, we closed 8,268 cases, which resulted in recovery of over $480 million. We have adopted an enforcement policy which focuses our resources; delivering the biggest bang for the buck and affecting the most participants possible.

The way we are able to do this is by focusing primarily on large plans—those with over 100 participants—and on service providers to plans. While large pension plans constitute only about 6 percent of all plans, they contain nearly 90 percent of plan participants and approximately 84 percent of all plan assets. Because most small plans are dependent on outside service providers such as consultants, plan administrators, and insurance companies, we are able to magnify our impact on small plans by focusing on those who provide services to hundreds, and in some cases, thousands of employee benefit plans.

By consciously focusing our investigations on those plans and service providers which have profiles that our experience has shown may lead to ERISA violations, we have uncovered ERISA violations in approximately one out of four cases investigated. This fact has been poorly translated by the media into an alarmist statement that "at least one out of every four private pension plans audited by the government violates the law," implying that one out of four pension plans have ERISA violations. We do not do audits. We do targeted investigations. We target these investigations, by and large, on plans which we believe have a high chance of violating the law.

A high percentage of violations uncovered through investigations is evidence of the success of our targeting efforts. Our goal is to maximize the effectiveness of our resources by sophisticated, successful targeting. Toward this end, over the past few years, we have developed a comprehensive computer information system which will provide us with the ability to electronically select plans based on computer models indicting likely violations. This new system will be operational later this year.

While the bulk of our cases are civil cases, I do not wish to leave you with the impression that we have neglected criminal cases. In the last 3 fiscal years, we have closed 76 criminal investigations, obtaining 35 indictments. This may not seem like a large number, compared to press reports citing 1200 criminal cases suspended by the Office of the Inspector General because of the Justice Department's opinion that such investigations were beyond the scope of his authority.

However, what the press reports do not say is that the overwhelming majority of these cases are not ERISA cases. We understand from the Inspector General that of those 1200 cases, there are only four open cases involving employee benefit plans. We are waiting for the Inspector General to refer these four cases to PWBA so that we can take action.

Finally, I wish to make some comments on the recommendations of the Office of Inspector General with respect to the standards governing the work of accountants who audit employee benefit plans. The first thing I would like to note is that these independent public accountants are just that—they are independent, private accounting firms, hired by pension plans. They are not government employees. The allegations of substandard accounting work that you read in the newspapers, to the extent that it is valid, is criticism of their work, not of the government's work.

That being said, I want to say that I think that the Inspector General has an important role in making recommendations to improve the ERISA enforcement program. PWBA has implemented many of the IG's prior recommendations, and I am personally reviewing the most recent recommendations. PWBA has also undertaken a series of self-initiated improvements designed to enhance ERISA enforcement.

In February of 1988, PWBA created an Office of the Chief Accountant. The Chief Accountant has worked closely with a committee of the American Institute of Certified Public Accountants—AICPA—charged with revising the audit guide used by independent accountants to audit employee benefit plans.

We are also working with the AICPA to improve their auditing procedures, and have developed refinements to our computer data system to help us develop targeting strategies in this area. We have referred, and will continue to refer, substandard work to the AICPA's division of professional ethics and to State licensing boards of accountancy.

We are continuing our efforts to improve the usefulness, for enforcement purposes, of the data required to be filed with the department. We substantially revised the annual report, Form 5500, and instituted an extensive public outreach program designed to familiarize plan officials and service providers with the new computer system and the new forms. This should improve the accuracy of the information we received and acquaint filers with the potential penalties for noncompliance.

In addition, Secretary Dole has initiated a department-wide review of criminal and civil enforcement strategies, including PWBA's enforcement activities. The department will, as a result of this review, evaluate the various strategies used, as well as the resources allocated to enforcement. The balance struck between criminal and civil enforcement will be part of this review.

Finally, I would add that the ERISA Advisory Council has established an enforcement working group to give guidance to the Secretary on enforcement issues. The Council unanimously adopted the working group's recommendations and has recently issued its report on a number of the issues which I have discussed. We have provided the subcommittee with a copy of that report for the record.

In view of the remarks of the Inspector General to this committee, I must add something on this subject. I feel it is unfair to this committee to impune their integrity. These individuals are of the highest integrity. They are highly respected, completely independent of the Labor Department, and they represent a complete cross section of the ERISA industry.

They represent accountants, lawyers, the public interest. We have three members representing unions. One of our members is a former congressman who was present in the Congress when ERISA was adopted. Another representing the public interest was on Senator Javits' staff when ERISA was adopted.

Having said that they are people of integrity, these people will only give advice. It does not necessarily follow that because they give the Secretary particular advice, she will follow it. In some cases, she does and in others she rejects it.

I think, for the record, it is unfair to impune their integrity.

In conclusion, I would like to state that as the new Secretary for Pension and Welfare Benefits Administration, I am pleased to take charge of the regulation of a fundamentally pension system. I take my responsibilities very seriously. One of my chief priorities will be to vigorously enforce ERISA. I look forward to working closely with you and the members of this subcommittee on these important issues.

Thank you.

[The prepared statement of David George Ball follows:]

STATEMENT OF
DAVID GEORGE BALL
ASSISTANT SECRETARY FOR PENSION AND WELFARE BENEFITS
U.S. DEPARTMENT OF LABOR
BEFORE THE
SUBCOMMITTEE ON RETIREMENT INCOME
AND EMPLOYMENT
SELECT COMMITTEE ON AGING
U.S. HOUSE OF REPRESENTATIVES

November 15, 1989

I. INTRODUCTION

Mr. Chairman and Members of the Subcommittee, my name is David George Ball. I am the Assistant Secretary of Labor for Pension and Welfare Benefits.

I am pleased to appear before you today to discuss the Department of Labor's general enforcement activities concerning private pension plans under the Employee Retirement Income Security Act of 1974 (ERISA). In addition, my testimony is intended to be responsive to several specific questions the Subcommittee has asked us to address.

Before I begin my discussion of ERISA and the Department's enforcement efforts, I would like to take a moment to reassure the nation's workers and retirees that the pension system is sound. Recent reports from our Inspector General and the press have questioned the safety and integrity of the pension system. We welcome this scrutiny and agree that we must be vigilant to prevent a crisis from developing. The Department is currently implementing several of the Inspector General recommendations. We are considering legislation to implement others. However, Secretary Dole and I are concerned that people may misunderstand and be alarmed about the current system. The pension system has, by any objective measure, never been healthier. We are committed to ensuring that this situation continues.

II. HEALTH OF PENSION SYSTEM

ERISA was enacted to ensure that employees receive their employment benefits and that adequate funds were set aside for those benefits. Prior to the enactment of ERISA in 1974, Congress found that many employees were in danger of losing their employee benefits because of the lack of adequate funds to pay those benefits. Since its passage in 1974, the assets of pension plans have grown from $290 billion to $1.7 trillion. Not only has there been a tremendous growth in plan assets, but plans are now better funded than when ERISA was enacted. In 1974, only 35 percent of pension plans were fully-funded. In 1988, 80 percent of plans were fully funded. ERISA's success has ensured that adequate funds are available for employees' retirement plans. The number of people receiving benefits from private pension plans was 4.8 million in 1975, and is expected to grow to 13 million by the year 2000. Underlying the success of the private pension plan system are the standards and enforcement mechanisms that were established by ERISA. It is also important to note that ERISA's minimum funding rules, together with the tax rules, have been substantially strengthened through recent legislation. This legislation (OBRA 1987) greatly increases the security of pension plans and the program that insures them.

III. ERISA'S ENFORCEMENT STRUCTURE

ERISA gave the Department responsibility for the administration and enforcement of Title I of ERISA. The Act provides that the Secretary of Labor, as well as plan participants and beneficiaries, may bring suit in Federal court against plan fiduciaries who have breached their fiduciary duties. The court is authorized to grant legal and equitable relief as it considers appropriate, and may impose attorney's fees and costs upon the breaching fiduciaries.

ERISA's reporting and disclosure requirements are an important element of its protective structure. Under those requirements, plan administrators must annually provide plan participants, beneficiaries and the responsible government agencies (the Department, the I.R.S. and the Pension Benefit Guaranty Corporation) with specific financial information. This information, which is reported in the Form 5500 annual report, can be used to determine, among other things, whether plans are properly managed, whether the rights of participants and beneficiaries are being protected, and, as I will discuss in more detail later, whether prohibited transactions have taken place.

As part of the annual reporting process, plan administrators are required to engage, on behalf of plan participants, an Independent Public Accountant (IPA) to annually audit plans covering 100 or more participants. (Plans with more than 100 participants hold the vast majority of total assets covered by ERISA.) The independent public accountant's examination must be conducted in accordance with generally accepted auditing standards, involving tests of the books and records of the plan, as considered necessary by the independent public accountant. The independent public accountant must also render an opinion as to whether the reported financial materials and schedules present fairly in all material respects the information contained in the financial statement.

ERISA also allows the Secretary of Labor, by regulation, to prescribe simplified annual reports for pension plans which cover fewer than 100 participants. Pursuant to this regulatory authority, the Department, in 1978, exempted pension plans with fewer than 100 participants from engaging an independent qualified public accountant to conduct an examination of the financial statements and schedules of the plan. It was felt that the burden and cost of comprehensive reporting and auditing procedures would discourage small plan sponsorship - the area where coverage is the lowest.

ERISA also established rules prohibiting certain transactions unless plans obtain a statutory or administrative exemption. These rules apply equally to small and large plans. Specifically, ERISA prohibits transactions between a plan and persons with certain relationships to the plan, who are defined as "parties in interest" under ERISA. In addition, ERISA prohibits plan fiduciaries from engaging in acts of self-dealing.

Under ERISA, the Department may grant an exemption from certain of these prohibitions if the Department finds that such exemption is (1) administratively feasible, (2) in the interests of the plan and its participants and beneficiaries, and (3) protective of the rights of the plan's participants and beneficiaries. During the last five years, PWBA has received a total of 2,421 applications for an exemption from ERISA's prohibited transaction provisions. Among the typical transactions for which exemptions have been granted are purchases and sales of assets between plans and parties in interest, secured loans by employee benefit plans to parties in interest, and leases of property by employee benefit plans to parties in interest.

In 1987, the Department requested that Congress provide a further tool to enforce ERISA. Congress responded by enacting a new section of ERISA, 502(c)(2), which provides civil penalties of up to $1,000 per day for the failure or refusal of a plan administrator to file the annual report. This provision is an integral part of the Department's enforcement strategy. Without accurate, timely data the utility of our new computer database system -- a key to our enforcement strategy -- would be severely diminished.

I would now like to discuss the present status of the Department's ERISA enforcement program.

IV. STATUS OF ERISA ENFORCEMENT

The Pension and Welfare Benefits Administration (PWBA) is responsible for the administration and enforcement of Title I of

ERISA. PWBA's Office of Enforcement oversees a national network of fifteen Field Offices located throughout the nation which conduct investigations designed to uncover violations of ERISA. The Office has 302 staff positions. In addition, we have an Office of the Chief Accountant which has responsibilities for the reporting enforcement program. This office has seven staff members.

The provisions of Title I of ERISA are largely civil in nature. PWBA, however, also has authority and responsibility for conducting criminal investigations involving violations of certain provisions of Title 18 of the United States Code relating to employee benefit plans.

As a result of our enforcement efforts, in Fiscal Year 1987, PWBA closed 1,672 civil investigations and obtained $117 million in total dollar recovery for plans. In Fiscal Year 1988, PWBA closed 1,597 civil investigations and obtained $103 million in total dollar recovery for plans. In Fiscal Year 1989, PWBA closed 1,553 civil investigations and obtained $111 million in total dollar recovery for plans. In Fiscal Years 1987 and 1988, PWBA closed 48 criminal investigations and obtained 24 indictments. In Fiscal Year 1989, PWBA closed 28 criminal investigations and obtained 11 indictments.

Investigations which disclose ERISA violations that do not involve the sort of abusive practices requiring court decrees to remedy are generally handled through voluntary compliance agreements. The Department is able to secure an agreement which is favorable to the plan in a majority of cases.

The overwhelming amount of our dollar recoveries result from such agreements. If voluntary compliance is not appropriate, civil cases are referred to the Solicitor of Labor's Office. Criminal cases are referred to the United States Attorney's Office for prosecution.

In civil cases, the Department seeks to obtain judicially enforceable court decrees. Such court decrees usually include: injunctive relief barring fiduciaries or other culpable parties from service to plans; the appointment of independent fiduciaries to manage a plan; obtaining monetary relief to restore plan losses; and obtaining injunctive relief enjoining fiduciaries from violating ERISA in the future.

In our continuing effort to improve the usefulness for enforcement of the data required to be filed with the Department, we substantially revised Form 5500, deleting items which experience had shown were unnecessary for enforcement, adding some items which were necessary, and reformatting the items so that they could be keypunched into our new computer system. We instituted an extensive public outreach program designed to familiarize those plan officials and service providers responsible for filing with the new system with the new forms so as to improve the accuracy of the answers and to acquaint them with the potential penalties for non-compliance.

The Department has traditionally targeted plans for investigation through various means. Plans are targeted for potential ERISA violations through computer analysis of Form 5500 annual reports and complaints from individual participants and beneficiaries, as well as referrals from other agencies. PWBA estimates that it will receive 1,372,000 Form 5500 reports in 1989.

As part of the Department's ongoing efforts to increase its enforcement capabilities, a new ERISA computer database system is being installed which will substantially improve PWBA's enforcement capabilities. Under the new system, the Form 5500s are sent to I.R.S service centers where data is key entered and subjected to extensive automated editing to identify errors or omissions. The I.R.S. will send tapes of automated data to PWBA every 30 days. The new database will greatly enhance PWBA's enforcement presence and deterrent effect. Data for case targeting will be available much more quickly than under the previous system. We expect the ERISA information system to be fully operational on June 1, 1990. The availability of complete automated data on all plans will also enhance our ability to conduct research and analysis of major policy and regulatory issues.

I would now like to discuss the Department's present ERISA enforcement policies.

V. DISCUSSION OF PRESENT ENFORCEMENT POLICIES

In an effort to make maximum use of our limited resources, PWBA has concentrated our enforcement efforts in certain areas where there is potential for serious abuse. In December 1986, the Department issued its ERISA Enforcement Strategy Implementation plan. Our enforcement strategy involves the concentration of 50 percent of investigative time on 2 carefully selected and designed "significant issues" that are characterized by a high potential for abuse of the fiduciary provisions of ERISA. These two areas are: (1) abusive practices of service providers to welfare plans and (2) abusive practices of financial institutions that manage and invest the assets of pension plans. The remaining 50 percent of our investigative resources are used to carry out a broader based program of general investigations involving the full range of ERISA covered plans and violations.

You specifically asked about the Department's enforcement efforts as they relate to pension plans with less than 100 participants. The Department continues to vigorously enforce the provisions of Title I of ERISA where violations are discovered, regardless of the size of the plan. We have brought, and will continue to bring, actions involving ERISA violations which concern plans with less than 100 participants. Although small plans are granted some regulatory relief from reporting requirements, they are held to the same fiduciary rules and the same civil and criminal sanctions as large plans are.

It has long been PWBA's policy to supplement our ERISA targeting efforts by seeking the assistance of various other governmental agencies in uncovering and in remedying ERISA violations. PWBA has a Memorandum of Understanding with the federal financial agencies and several state agencies for the sharing of information and referral of cases. PWBA maintains informal relationships with the Securities and Exchange Commission and other agencies for the sharing of information and the referral of cases. PWBA has a coordination agreement with the Internal Revenue Service (I.R.S.) which delineates the respective enforcement authorities of the two agencies under ERISA and establishes a process for the referral of cases or information regarding on-going investigations. The I.R.S. also has authority under the Internal Revenue Code to enforce the prohibited transaction provisions of ERISA. PWBA has found that in certain cases enforcement by the I.R.S. is a viable alternative to our bringing suit under Title I of ERISA. PWBA also maintains a formal relationship, via a Memorandum of Understanding, with the Department of Justice. The Memorandum of Understanding establishes guidelines for the investigation of criminal matters and provides that all criminal cases will be referred to the Department of Justice for prosecution. We believe this policy of inter-agency cooperation greatly enhances PWBA's ability to carry out its enforcement responsibilities.

You have asked whether our present enforcement policies are sufficient and if there are adequate penalties to serve as a deterrent to the commission of ERISA violations. We do not believe that any enforcement agency, including PWBA, will ever have sufficient resources to fully investigate every potential violation within its jurisdiction. We have attempted, and in our opinion have been successful, in channelling our resources into areas that we believe will best protect plans and will also serve as a deterrent to other potential ERISA violators.

VI. RECENT ACTIVITIES IN ERISA ENFORCEMENT

Secretary Dole has recently initiated a Department-wide review of the criminal and civil enforcement strategies for the various programs, including PWBA's enforcement activities. The Department will, as a result of this review, evaluate the various enforcement strategies used as well as the resources allocated, which will include consideration of the balance between criminal and civil enforcement.

As you know, the Department's Office of the Inspector General (IG) has made a number of recommendations concerning ERISA enforcement generally, and the role of the Independent Public Accountant (IPA) in particular. As the name implies, an independent public accountant is an independent private accountant that is hired by the plan. PWBA has implemented many of the IG's prior recommendations and is in the process of reviewing the most recent. The IG has recommended, among other things, that standards be set for Independent Public Accountant performance; that a working relationship be developed between PWBA and the American Institute of Certified Public Accountants (AICPA); and that the AICPA be encouraged to establish an ERISA practice section. In February of 1988 PWBA created an Office of the Chief Accountant. One of this office's primary functions is to work with the AICPA and the Financial Accounting Standards Board. In particular, the Chief Accountant has worked closely with the AICPA Committee charged with revising the audit guide for audits of employee benefit plans. We are also working with the AICPA to improve auditing procedures, and we have developed refinements to our data system to help us develop targeting strategies in this area. We have referred, and will continue to refer, substandard work to the AICPA's division of professional ethics and to state licensing boards of accountancy.

The IG has also recommended that Independent Public Accountants be required to conduct compliance testing of fund operations, be directed to search for any prohibited transactions and report their findings directly to the Department. PWBA believes that requiring compliance audits raises a number of critical issues, not the least of which is whether any increased protection for plan participants that may result from compliance audits justifies the increased costs to plans that would be imposed by such audits. Careful study of this issue is necessary because such increased costs may result in lower benefits for plan participants. Towards this end, we are designing a model compliance auditing program from which to evaluate costs and benefits of such a program.

The IG has also recommended the elimination of limited scope audits. ERISA permits a plan administrator to exclude from the scope of an IPA's examination those assets held in trust by a bank, insurance company or similar institution which are subject to routine regulatory oversight. These audits are known as limited scope audits.

Limited scope audits originally were permitted under ERISA because these institutions are subject to regulation and audit by other government agencies and Congress believed it would be duplicative and costly to have additional audits. PWBA agrees with the IG that the issue of limited scope audits deserves re-examination. Obviously, the costs to pension plans resulting from eliminating this exception need to be carefully weighed against the resultant benefits. The Department is considering whether to recommend eliminating limited scope audits.

I would like to state at this time that we will be working closely with the IG to review and analyze the feasibility of implementing his recommendations, and to reach agreement on ways to enhance enforcement.

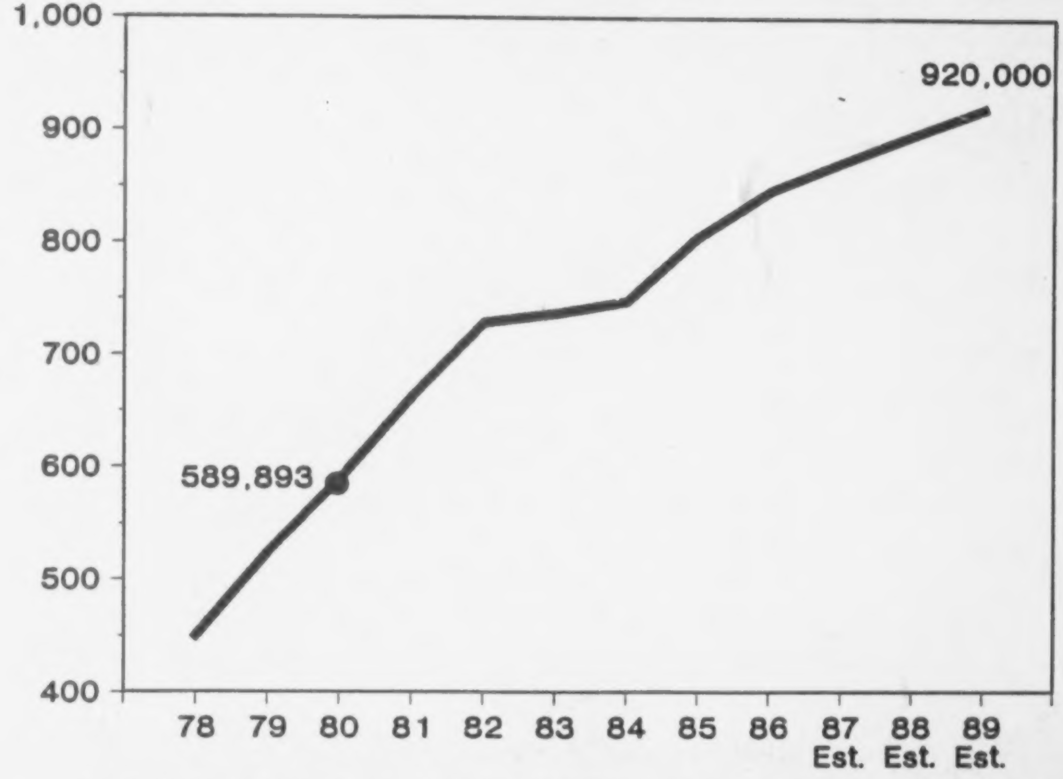
Finally, I would add that the ERISA Advisory Council has established an enforcement working group to give guidance to the Advisory Council on enforcement issues. The working group has recently issued its report on a number of the issues which I have discussed. We have just begun our examination of this report and are providing the Subcommittee with a copy of that report for the record.

VII. CONCLUSION

In conclusion, Mr. Chairman, the Department believes that the Nation's private pension system is sound, and we are continually taking steps to enhance our enforcement efforts to ensure the continued security and integrity of that system. I will be happy to answer any questions you may have at this time.

Number of Pension Funds

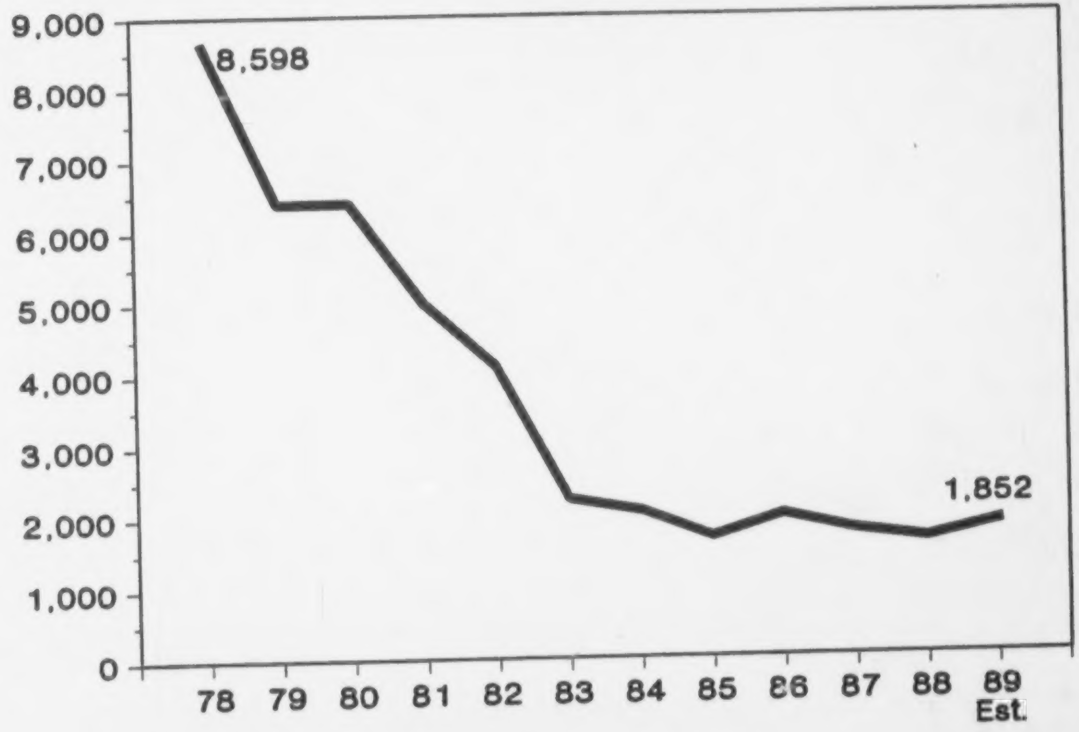
In Thousands



Source: Department of Labor, Pension and Welfare Benefits Admin.

Number of Investigations and Plan Reviews by Labor Department

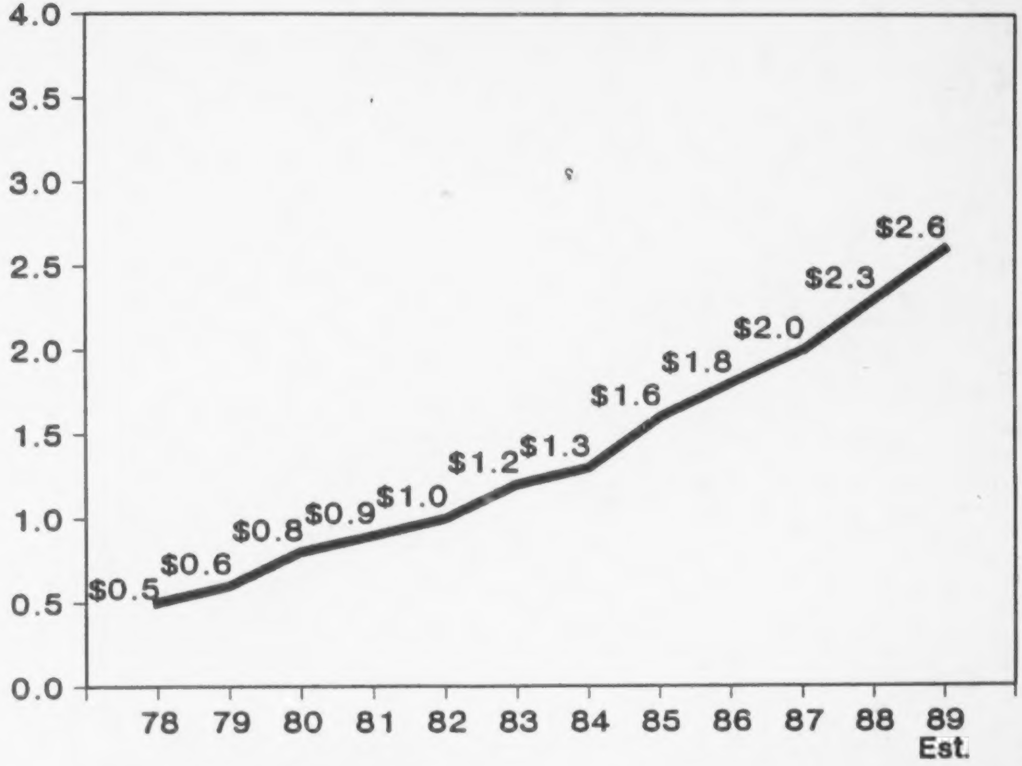
In Thousands



Source: Office of Management and Budget

Pension Fund Assets

In Trillions of Dollars



Source: Labor Department

Mr. Hughes. Thank you very much, Mr. Ball. First of all, let me just pick up on your last comments about the Working Group. I don't know that the Inspector General was attempting to impune their integrity. I worked 25 years with the criminal justice system either as a prosecutor or as a legislator.

I think some of the suggestions made by the enforcement Working Group raise a lot of serious questions as to where they are coming from. When they question, "Would an enhanced criminal enforcement program interfere with an effective civil enforcement program, for example by discouraging voluntary cooperation for fear of prosecution, or by diverting scarce budgetary resources," it raises the question of whether or not they understand the need for deterrents in the system.

It is going to be more than just rewarding those that violate the law by just slapping their wrists. I would have the same basic question myself about that question.

Mr. Ball. Well, Mr. Chairman, I don't want to get into a position of defending the particular pieces of advice they forwarded to the Secretary, because I think it is highly likely in some cases the Secretary will not accept that advice.

I think they were motivated by a general concern that the report of the Inspector General was frightening pensioners. As I mentioned in my remarks, I think it is very important that the first thing to be said is to reassure people that the pension system is sound and health.

Mr. Hughes. We want to do that. I think it is unfortunate that the issue has been somewhat distorted. You know, we are talking about pension assistance. I don't think a month goes by that I don't hear from some senior citizen in particular who is worried that his pension is going to be there or somebody who has worked most of their lifetime who wonders whether or not their pension will be intact when they retire.

There has been a lot of concern. In my area, we have had some pension abuses which have made people very apprehensive. When you look at the dimension of what could be the problem, you can understand why people are concerned.

I don't know what is going on at the Department of Labor. I think we ought to find out. I have been in Congress 15 years. I see turf battles every day, particularly with the law enforcement agencies. It seems impossible to get people moving in the same direction.

We have an important opportunity with a new Undersecretary working in a very key area and the Inspector General trying to do his job, to get off on the right foot and try to address the problems. I think the way you have approached it is commendable. I hope we can focus in on some of the shortfalls and try to correct them.

I have just a few questions, and I will recognize the ranking Republican. One of the things that concerns me—aside from the question of how much fraud and abuse is out there, which nobody can tell us at this point—is the dimension of the pension problem. There are 870,000 private plans, 5 million welfare supplemental plans, and $1.7 trillion in assets. Just looking at the charts up here, we have seen the pension funds grow, and thankfully from 1978 from about 450,000 to about 870,000 plans during that period of time.

Meanwhile, the number of investigations by the Department of Labor have gone from 8,598 in 1978, down to 1,852 investigations estimated this year. To me, that is an invitation to disaster. Aside from the question of how much fraud and abuse is out there, having worked for 25 years in the criminal justice system, I can tell you we are inviting disaster, unless we up the ante and increase deterrents and do a far better job of looking at plans.

Wouldn't you agree that that has got to be the case?

Mr. BALL. Yes, I agree with you there is a need for greater vigilance. That is exactly what I intend to do as Assistant Secretary, that is exactly what the Labor Department is trying to do.

The greatest assets in this new vigilance will be the fact that with our new computer analysis, we will be able to look at all the 1 million Form 5500s that are filed. Because we have developed criteria for targeting, you are likely to see the number of investigations grow. We have a new tool, a new weapon to work with. We intend to use it vigorously.

Mr. LEBOWITZ. Mr. Chairman, if I might try to explain the numbers, as with any statistic, it is important to know what you are counting.

Between now, 1978 and now, our agency has gone through a number of different case management systems and organizational structures. The two numbers are really not compatible at all. In 1978, the organization counted as an investigation any time one of our people picked up the annual report and looked at it to see if the numbers added up. You can judge for yourself why those kinds of reviews were called investigations, but we no longer consider them to be investigations, and we don't count them. The only thing we could now as an investigation is something I think all of us would agree is a comprehensive review of the activity of a plan. So they are not comparable numbers.

Mr. HUGHES. Let's put aside the numbers for a minute. You are not going to sit there and tell me, are you, that 270 compliance investors can possibly look at $1.7 trillion in assets, 870,000 plans, with plans coming on line every day, are you?

Mr. LEBOWITZ. No, certainly not. I was trying to put that other number in some perspective.

Mr. HUGHES. I understand that. I understand a lot of it has to do what with what you count as investigations. I happen to agree 100 percent with Mr. Maria at least in a couple of areas. One is that we need to treat corporate racketeers just like we treat labor racketeers. There should not be any difference. Is there any quarrel about that?

Mr. LEBOWITZ. No one is here defending racketeers, Mr. Chairman.

Mr. HUGHES. We have an aggressive agency within the Department of Labor, which has had a commendable record on going after labor racketeering. We have not had that on the other side. We don't need a dual standard. That is not appropriate.

I also agree that unless you make egregious violations, something that will call for severe criminal penalties, you will not deter them. If program managers who bilk these funds are not at risk, they will consider civil penalties a cost of doing business, and you are not going to accomplish one thing.

I am interested in looking at what deterrents we have there. I am also on the Judiciary Committee where I chair the Subcommittee on Crime. It is not satisfactory to have a good strategy on the civil side.

You need to have a vigorous criminal prosecution strategy at the same time. Would you quarrel with that?

Mr. LEBOWITZ. No, I would not. I think our strategy is not a civil strategy or a criminal strategy. It is an enforcement strategy. What it does is focus the resources that we do have in the best way that we think we can use them to develop facts, which is what any investigator does.

An investigator finds facts and then makes conclusions on the basis of those facts as to whether or not a prosecution should proceed, civil or criminal prosecution.

I would point out that Mr. Maria made reference to the SEC. We certainly have the highest admiration for our colleagues at the SEC, but that is precisely what they do. My understanding is that the SEC itself does not have criminal investigators.

They have investigators, just as we do, find facts and make judgments about how best to proceed. When they believe that the facts indicate that a criminal violation has occurred, they will work with the U.S. attorney and the Justice Department. That is the method we use in conducting our investigations.

Mr. HUGHES. I don't know that you can compare SEC with DOL responsibilities in the pension area. But putting that aside, just looking at the sheer numbers, the number of criminal investigations opened, the number of criminal investigations closed in the last 3 years, the number of indictments sought, it just tells me that the strategy is a civil strategy.

You could not persuade me that that is not the case because frankly the numbers describe the strategies otherwise. You could not persuade me when you are only opening less than 100 cases in a given year and you have 5,000 investigations that you are pursuing, that you are really looking at criminal enforcement.

Mr. LEBOWITZ. I think we would regard the total of our investigations both civil and criminal as just investigations which produce certain results some of which were achieved in a civil context and some of which were achieved in a criminal context.

I think it is important to keep in mind that ERISA itself, the basic statute that we work with, is overwhelmingly, almost entirely a civil statute. With a couple of relatively minor exceptions, it has no criminal penalties. The penalties are all civil and tax related, as well.

Mr. HUGHES. We have Title XVIII violations.

Mr. LEBOWITZ. Yes, sir, there are; and we do pursue them.

Mr. HUGHES. The fact of the matter is that we have some Title XVIII violations that we are not pursuing.

My time has expired. I recognize the gentleman from Iowa.

Mr. TAUKE. Thank you, Mr. Chairman.

First, Mr. Ball, you indicated that the number of investigators you have at the current time may be inadequate. How many investigators do you think the department should have in this area?

Mr. **Ball**. Congressman, we are currently reviewing the number of investigators we have because we are considering requesting additional investigators. However, I would like to bring to your attention a related point, quite apart from us asking for additional help which we are considering doing at this time.

I am deeply concerned that the House-Senate Conference has recently passed down to us a reduction in our budget. This will result in a reduction in staff.

Mr. **Tauke**. You are getting ahead of me, but that is the exact point I was going to ask. If you wanted more inspectors, how was Congress responding in terms of the appropriations side. You are suggesting that you don't have the resources.

Now, in terms, Mr. Maria, of the resources they do have, do you think that they are employing the resources well, or are you criticizing the way that the department is employing its investigative resources?

Mr. **Maria**. I want to be consistent in this. Our concern has been with the imbalance between the size of the benefit plan universe and the number of investigators available, compliance people with the Department of Labor.

Mr. **Tauke**. Are you saying there are inadequate numbers?

Mr. **Maria**. There are inadequate numbers. Given my conservative nature and the office I represent, before we consider adding more people to the Federal payroll, I think it is important to make certain, to be doubly certain you are getting the maximum return on investment from the individuals that you now have and that you have a strategy which is, in fact, very effective.

We have some severe questions with respect to the strategy now. We think it is ineffective, intrinsically flawed, because there is an inordinate reliance on the civil process.

There has been a failure today to have complimentary strategies. The Inspector General clearly has resources and competence to conduct criminal investigations, but until we can perform an adequate marriage between the criminal investigative process and the civil investigative process—

Mr. **Tauke**. Let me not get into what the Inspector General's role should be. I am asking, with the investigators the Department of Labor has, do you think they are employing those resources well?

Mr. **Maria**. Not under the current strategy, no.

Mr. **Tauke**. The primary concern that you have about the current strategy is that it is a civil strategy versus a civil-criminal strategy.

Mr. **Maria**. That would be my recommendation, yes.

Mr. **Tauke**. Mr. Ball, you indicated in your testimony that you had 76 criminal investigations, obtained 35 indictments over the last 3 years. Obviously there is some criminal component. My assumption is that these investigations were actually pursued by the Department of Justice; is that correct?

Mr. **Ball**. Yes.

Mr. **Tauke**. After being referred by your agency?

Mr. **Ball**. After we had done the initial investigation. As we do our investigations, we don't start off looking for civil or criminal. We start with the investigation, and as we get into it, we may discover there is a criminal matter in that case we refer the matter to the Department of Justice.

Mr. **Tauke**. Mr. Maria, what don't you like about that system?

Mr. **Maria**. I think the numbers speak for themselves when you have 95 cases that have been classified as criminal investigative matters out of 5,000.

Mr. **Tauke**. You think they should be referring more. Did you find in your analysis that some of the investigations they had done did contain criminal misconduct that was not referred to the Department of Justice?

Mr. **Maria**. We have not examined those other investigations which were pursued civilly. No, we have not done that.

Mr. **Tauke**. I am having a little difficulty both with the assertion of the Chairman and your assertion that the numbers speak for themselves. In my mind, they do not speak for themselves. If you say there are 5,000 investigations and 95 are referred to the Department of Justice for criminal investigation, how do I know that is high, low, or in between?

Mr. **Maria**. Can you assure yourself that 95 cases were referred to the Department of Justice, or were they opened as criminal investigations? There is a difference.

Mr. **Tauke**. Can you tell me?

Mr. **Maria**. I don't know.

Mr. **Tauke**. But you are the one who is making the assertion that they are not doing the job on the criminal side. How do you reach that conclusion?

Mr. **Maria**. I am opting on the premise that there is substantial fraud and abuse. We have the statistics in our Office of Labor Racketeering. The same middlemen and service providers who pillage the plans are doing the same in public sector and nonunion plans today. Who focuses on that vulnerability and deprivation? Let me develop this point.

Is that a sufficient number? We have 300 benefit-related convictions in the Office of Inspector General in the last 10 years. Now who looks at whose vulnerabilities which suggest criminal exploitation? I can tell you that those 300 convictions, not indictments but we are talking about convictions, not one of those investigations was ever initiated as a result of information on the Form 5500 nor as a result of anything contained in the Independent Public Accountant's report.

If you are going to address the intrinsic evil nature of man, miscreants and corruption, it is important to have a diagnostic capability to know when and how to look at it.

I represent right now in the Office of Pension Benefits Welfare Administration that skill does not repose there.

Mr. **Tauke**. Do you think they need a separate investigative team of some kind within the department?

Mr. **Maria**. What I have recommended in my previous testimony is that given our physical restraints within the Department of Labor and the rest of the government it would make infinitely good sense to first exhaust investigative capability that now reposes in the Office of Inspector General where we have the only Federal criminal investigators in the Department of Labor. It makes sense to use them first before considering adding another capability.

Mr. **Tauke**. I am not particularly interested at the moment in getting into the battle between the Department of Justice and the Inspector General over the scope of your authority. I am trying to find out if the Department of Labor is doing a good job with the resources they have—setting aside for the moment this other dispute—I guess that is where we are having a little difficulty.

Let me pursue this a little differently. You indicated you had 1200 criminal cases that were thrown out. Secretary Ball indicates that only four of those were actually ERISA cases if I understand his testimony correctly. Is that a fair assessment?

Mr. **Maria**. That is my understanding of his testimony.

Mr. **Tauke**. Do you agree with it?

Mr. **Maria**. I do not disagree. The term "thrown out" is incorrect. When that term was rendered by the Department of Justice, given the legal liability raised for our agents, the Department of Justice said the Office of Investigations Special Agents did not have authority to conduct certain investigations.

It is a highly intrusive business. I am not going to assign them investigations where there is a question of jurisdiction because if sued, they would not be defended by the Department of Justice.

Their defense would come out of their own pocket. That would be unconscionable. What I said and the record will bear me out, I said investigation was suspended, and we identified a group of cases that were impacted. We conducted a case-by-case review; that was no small task. We did not say they were thrown out.

Admittedly, if I may finish developing this point, admittedly I believe the number is closer to 15 benefit plan cases. Why the small number? Only because the Office of Investigations began to conduct benefit plan fraud investigations in late 1986.

Mr. **Tauke**. What were the other 1185 if 15 were benefit fraud?

Mr. **Maria**. If you will bear with me, I believe I have that information. I will describe them by programs affected.

We are dealing with claimant fraud in the Federal Longshore and Harbor Workers Statute, unemployment insurance fraud, we are dealing with wage and hour programs fraud, alien certification.

Mr. **Tauke**. I am getting the general picture. You are saying 15; Secretary Ball said four that were ERISA related. Is that a fair assessment?

Mr. **Maria**. Yes.

Mr. **Tauke**. What happened to those 15?

Mr. **Maria**. I cannot give you the breakdown of the 15. I will supply it for the record. Generally some have been retained by the Office of Investigations for the following reasons notwithstanding the opinion: Active field investigation had ceased, and they were in a pre-trial phase so the agents at that juncture were no longer engaged in the intrusive business of field investigation but were, in fact, assisting the prosecutor in preparing for trial.

We have various categories. Some could have been referred to other agencies where there was a joint investigation. Some are presently being examined by the Office of Labor Racketeering to determine if there are indications of racketeering and if so, they could be assumed by the Office of Labor Racketeering. The critical point is that the entire investigative process, when that opinion was rendered, the process was interrupted. Investigations don't get better with age. Only bad things happen with the passage of time.

Mr. TAUKE. I understand your frustration at the Department of Justice's decision. I am not here to debate whether or not that was right or wrong, and what the role of the IG should be. Congress may have to address that issue. I guess what is of concern to me is the assertion that the system is running rampant; fraud is running rampant in the pension system of the Nation.

We read the assertion being made in the newspapers that there were 1200 criminal cases relating to ERISA that were thrown out or whatever, were dumped as a result of the decision by the Department of Justice. It makes it sound as if every pension system is in trouble, and we that have fraud, criminal abuse all over the place. I am having difficulty, I guess, reaching that conclusion. I understand that there are a lot of potential problems out there. It would be great if we had a lot more money available for a lot more investigators. I think we need to look at the strategy being used for the investigations underway.

At the moment, I am not finding the evidence to suggest, A, criminal activity is rampant in the system or B, that we have lots of cases out there that are not being pursued. Am I missing something?

Mr. MARIA. I want the record to be abundantly clear, neither in my testimony, public comments, or in our reports have we ever suggested that fraud was rampant and that pensions and welfare plans were in danger. We are saying that there are vulnerabilities. We have records and I will submit for the record a synopsis of the 300 convictions. It will demonstrate to the members of this subcommittee the kinds of criminal schemes that occur.

If we had that as a historical base, it seems prudent to me that if you had an investigative component required to do diagnostic work to determine if these same abuses are occurring in other plans.

Mr. HUGHES. That will be received for the record.

Mr. TAUKE. What you are suggesting to us first is that the Inspector General be able to pursue criminal cases. But are you suggesting that the department should change its current practice of investigating and then referring to the Department of Justice and adopt a different posture?

Mr. MARIA. What I am suggesting in very summary fashion, what I am suggesting is that the Department of Labor develop a comprehensive enforcement strategy as it relates to protection of employee pension and welfare plans.

We have four agencies whose daily work impacts in that area, pension and welfare benefits administration. We have the Pension Benefit Guaranty Corporation, Wage and Hour Division, and the Office of Inspector General. They don't even talk to one another. They generate information on a daily basis which impacts on ERISA.

There is no central point of synthesis. There is no setting or priorities so that the most egregious problems can be addressed in the most effective fashion, and so that we are assured that a transgression, if committed, reserves a punishment commensurate with the offense. That is point one. Point number two, why not, if we had the potential for fraud and we have a diagnostic criminal investigative capability, why shouldn't it be allowed to function?

It was the Department of Labor that elicited this opinion from the Department of Justice. As flawed as the opinion was, if it had not been for Department of Labor, we would not have it.

Mr. BALL. May I clarify whether there are 1,200 suspended criminal cases related to pension plans or four. I would submit for the record a letter from Deputy Secretary Roderick A. DeArment to the Honorable Tom Lantos that clarifies that there are only four open criminal cases.

Mr. HUGHES. Without objection, it will be so received.

[The material submitted by Mr. Ball follows:]

U.S. DEPARTMENT OF LABOR
DEPUTY SECRETARY OF LABOR
WASHINGTON, D.C.
20210

November 14, 1989

Honorable Tom Lantos
Chairman
Subcommittee on Employment and Housing
Committee on Government Operations
House of Representatives
Washington, DC 20515

Re: Labor Department Enforcement

Dear Mr. Chairman:

You know of the commitment that Secretary Dole and I have made to ensuring that the Department of Labor (DOL) effectively enforces the laws which protect the health, safety and welfare of American workers, including those relating to maintenance of the integrity of the Nation's private pension system. This concern is reflected in our recent Department-wide review of all enforcement activity, and in our current efforts to make sure that all enforcement cases -- including ERISA cases -- are promptly processed by the appropriate DOL agency. This letter reports on recent developments and clarifications regarding the enforcement jurisdictions of DOL program agencies and DOL's Inspector General.

During your Subcommittee's August 2, 1989 hearing on ERISA enforcement, you asked that the Labor Department seek clarification of a March 9, 1989 opinion of the Justice Department's Office of Legal Counsel (OLC) concerning the enforcement jurisdictions of the Labor Department's Office of Inspector General (OIG or IG) and the Department's program enforcement agencies. In my September 18, 1989 letter to you reporting on Labor Department ERISA enforcement efforts, I noted that the Solicitor of Labor and the IG had been reviewing and discussing the OLC opinion, and that I would advise you of any clarifications arising from such discussions.

The next day, September 19, 1989, I asked the Acting IG in writing to provide me a prompt report of all criminal enforcement cases within OIG affected by the OLC opinion, and recommendations for their disposition.

After waiting several weeks for a response, I was informally advised by the IG that he was referring these cases to the Justice Department. Apparently some of the cases (or summaries thereof) were referred to Justice, although Justice returned them to the Labor Department on October 27, 1989, because they represented what Justice called "uncompleted investigations". Apparently the bulk of the approximately 1200 cases was not referred to the Justice Department.

Finally, on November 6 the Acting IG provided the Solicitor with a one-page list (copy attached) of 371 cases reportedly ready for transfer from OIG to DOL program enforcement agencies. Because I was concerned that this transfer take place as soon as possible, I directed the Solicitor to promptly examine this list of cases and provide me recommendations for their disposition (see attached memorandum dated November 14, 1989). The OIG list and the Solicitor's analysis reveal the following:

1. While OIG stated that processing of approximately 1200 enforcement cases -- refined to 1,192 in OIG's October 31, 1989 draft Semiannual Report -- had been "suspended" due to the OLC opinion, of those 1,192 OIG has closed 315 cases, 356 await action by prosecutors, U.S. Attorneys have asked OIG to continue investigating 108, and cooperating agencies are handling 42, according to the OIG Report.
2. This leaves 371 cases, including those the Justice Department referred back to the Labor Department.
3. Of those 371, based on OIG descriptions 285 appear to involve unemployment insurance matters. I have asked the Acting IG to examine these and certain other cases -- totalling about 300 -- to determine whether further IG or state investigative activity should follow.
4. Of the remaining approximately 70 cases, according to the IG's Nov. 6 list, only four (4) involve possible "ERISA pension plan fraud." In light of the IG's stated concerns regarding the status of the Nation's private pension system, this seems an exceedingly small number.[1]

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[1] By comparison, the Department's Pension and Welfare Benefits Administration (PWBA) closed 48 ERISA criminal investigations and obtained 24 indictments in FY 1987-88, and during the first 9 months of FY 1989 closed 22 ERISA criminal investigations resulting in 6 indictments.

I have directed the Labor Department's program enforcement agencies to act promptly upon referral to them of the remaining approximately 65 cases (see attached memorandum), which represent about 5% of the original 1,192 cases.

It thus appears that processing of most of the "1200 cases" publicly referred to by OIG has not in fact been delayed by the OLC opinion. Moreover, those cases from that group which remain open are now being, or soon will be, disposed of by the appropriate enforcement agencies. Finally, I see no evidence in these recent developments which suggests that America's private pension system is at risk.

The Department of Labor will be pleased to provide additional information to your Subcommittee upon request.

Sincerely,

Roderick A. DeArment

Attachments

DEPARTMENT OF JUSTICE CASES TO BE REFERREDTO THE DEPARTMENT OF LABOR AGENCIES.

CASES READY TO BE TRANSFERRED AS OF NOVEMBER 6, 1989:

TOTAL CASES 268

ency	Case Category	ICTS Case Code	Distribution of Cases (Not Including DOJ Referrals)	Distribution of Cases Referred to DOJ on 9/26/89	Distribution o All Case Referred t Deputy Secretar
SA:	LHWCA Claimant Fraud	0462	1	8	
SA:	CMWC Claimant Fraud	0464	3	1	
SA:	CMWC Provider Fraud	0465	5		
SA:	Wage & Hour Programs Fraud	0469	9	14	2
SA:	Other	04AO	1		
BA:	ERISA Health Plan Fraud	2680			
BA:	ERISA Pension Plan Fraud	2681		3	
TA:	USES Alien Certification Fraud	3960	4	1	
TA:	UIS Fictitious Employer Scheme	3962	1	2	
TA:	UIS Claimant Fraud (R Ben, EB, FSC)	3957	169	52	22
	Total:		193	75	26

268

CASES TO READY FOR TRANSFER TO PROGRAM BY NOVEMBER 17, 1989 AS IDENTIFIED BY RIGI'S:

TOTAL CASES 103

		12AO	1
3A:	LHWCA Claimant Fraud	0462	5
3A:	CMWC Claimant Fraud	0464	4
3A:	CMWC Provider Fraud	0465	4
3A:	Wage & Hour Programs Fraud	0469	24
3A:	Other	04AO	1
3A:	ERISA Health Plan Fraud	2680	0
3A:	ERISA Pension Plan Fraud	2681	1
'A:	USES Alien Certification Fraud	3960	0
'A:	UIS Fictitious Employer Scheme	3962	1
A:	UIS Claimant Fraud (R Ben, EB, FSC)	3957	62
	Total:		103

EN ROUTE

85 vs. 75

1 - OLR

9 + joint [illegible] [illegible]

TOTAL CASES 371

U.S. DEPARTMENT OF LABOR
DEPUTY SECRETARY OF LABOR
WASHINGTON, D.C.
20210

November 14, 1989

MEMORANDUM FOR RAYMOND MARIA
Acting Inspector General

FROM: RODERICK DeARMENT

SUBJECT: Expeditious Disposition of OIG Cases

On September 19, 1989, I requested by memorandum a report on your office's review of open files to determine which investigations might be affected by the opinion of the Office of Legal Counsel regarding the authority of the OIG to conduct "programmatic" investigations. I also asked for your recommendations for the assignment of some open cases between the OIG and the DOL program agencies, and how the transfer to program agencies should be effected. As set forth in my September 19 memorandum, this information is needed by the Department so that those matters can be handled as expeditiously as possible.

I have now received a report from the Solicitor (copy attached), based upon one page of summary information which you provided to him on November 6, 1989. I would like to draw your attention initially to two matters.

First, at various times you made public statements that approximately 1,200 pending cases of various types are affected by the OLC opinion. The information that you have now supplied indicates that you have identified only 371 cases for transfer. The balance of the cases are apparently being handled by or in coordination with other federal agencies, or are being completed by your office, or have been terminated for reasons other than apparent lack of authority under the OLC opinion.

Second, in the four days since you provided the summary information to the Solicitor, he has determined, as set forth in the attached memorandum, that your office may be authorized to continue investigating or otherwise dispose of as many as approximately 300 of those 371 cases, in that the OLC opinion does not necessarily limit the authority of your office in these matters.

I am directing that the Office of the Solicitor and the appropriate program agencies in the Department[1] contact your office immediately, so that the cases which are to be transferred can be transferred promptly. The program agency personnel, with advice from the Office of the Solicitor, will look forward to receiving the files[2] and will arrange for appropriate staff to be briefed personally on the cases by OIG personnel. I understand that you have also indicated that OIG will be able to provide technical assistance to the agencies for transferred cases which should facilitate continued investigation and disposition of these matters.

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[1] Those agencies are: Employment and Training Administration (for unemployment insurance and alien certification cases); Employment Standards Administration, Office of Workers' Compensation Programs (for Longshore cases); Employment Standards Administration, Wage and Hour Division (for wage and hour programs cases); and Pension and Welfare Benefits Administration (for ERISA cases).

[2] As indicated in the Solicitor's memorandum, you should provide to the Office of the Solicitor more detailed information as to case type for the matters listed in the November 6 summary table of cases under the categories of "SA: Other", "TA: UIS Fictitious Employer Scheme" and "TA: Claimant Fraud (R Ben, EB, FSC", so that final determinations on the transfer of cases in these categories can be made by the Solicitor.

U.S. DEPARTMENT OF LABOR
DEPUTY SECRETARY OF LABOR
WASHINGTON, D.C.
20210

November 14, 1989

MEMORANDUM FOR ROBERTS JONES
Assistant Secretary, ETA

WILLIAM BROOKS
Assistant Secretary, ESA

DAVID BALL
Assistant Secretary, PWBA

FROM: RODERICK DeARMENT RAD

Following recent discussions among the Solicitor of Labor, Inspector General and me, there have been identified a limited number of cases formerly within the Inspector General's custody which should be referred to your agencies for further enforcement activity.

Please (1) contact the Acting Inspector General immediately to obtain the appropriate files; and (2) review them with the appropriate Associate Solicitor of Labor and act upon them without delay. In addition, please report to me at your earliest convenience which cases you have received from OIG and your plans for promptly completing them.

Thank you for your cooperation.

cc: Secretary Dole
Acting Inspector General Maria
Solicitor of Labor Davis

U.S. Department of Labor

Solicitor of Labor
Washington, D.C. 20210

NOV 13 1989

MEMORANDUM FOR THE DEPUTY SECRETARY

FROM: ROBERT P. DAVIS R.P.D.

SUBJECT: Disposition of Cases Previously Referred to the Department of Justice by the OIG

BACKGROUND

As you know, on September 19, 1989, you wrote to Inspector General Hyland noting that the OIG was currently reviewing a substantial number of open files to determine which investigations might be affected by the opinion of the Office of Legal Counsel regarding the authority of the Department's Office of the Inspector General to conduct "programmatic" investigations. You noted that the OIG and the Office of the Solicitor were currently working together to resolve any situations where the lines of authority remained unclear.[1] In an effort to assure that the files are handled properly and as expeditiously as possible in light of the OLC opinion, you requested a report from the Inspector General on:

(1) the size and composition of the universe of cases affected by the opinion;

(2) recommendations for the assignment of open cases between the OIG and the DOL program agencies; and

(3) how the transfer of cases to the program agencies should be effected.

On October 3, Acting Inspector General Maria indicated that the OIG was working to determine the appropriate disposition of approximately 1200 affected cases which had been identified. He stated at that time that the OIG did not intend to refer any cases to DOL program agencies because many contained grand jury materials and because the remaining cases involved Title 18 violations which were being referred directly to the Department of Justice. Mr. Maria noted that a number of cases had already been referred to the Department of Justice. In fact, you were later advised by the Justice Department (see discussion below) that on September 26, Mr. Michael Ryman, Assistant Inspector General for Investigations, had transmitted to the Department of

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[1] After several discussions, Inspector General Hyland requested and I agreed that a clarification from OLC of its opinion would not be sought. Instead, OIG proceeded to identify those pending cases that OIG believes are outside its investigative jurisdiction under the OLC opinion. See discussion infra.

Justice a box containing materials relating to a group of pending cases which, in light of the OLC opinion, the OIG had determined were outside the OIG's authority to investigate. Mr. Ryman's letter to the Justice Department noted that while OIG rejected the legal analysis of the OLC opinion, prudence demanded that OIG cease investigative activity in connection with matters that reasonably fell within the opinion.

On October 27, in response to Mr. Ryman's September 26 correspondence, you received a letter from Mr. John C. Keeney, on behalf of Mr. Edward S. G. Dennis, Jr., Assistant Attorney General, Criminal Division. Mr. Keeney's letter stated that the previously transmitted cases appeared to represent uncompleted investigations, and they were being returned for your appropriate disposition. The OIG took custody of the box pending a decision concerning the disposition of the cases.

On November 2, Mr. Maria again wrote to you indicating that he was planning to transmit to you directly not only the cases which had been sent to DOJ, but most of those additional cases which remained in the OIG inventory and were subject to referral. He noted that OIG efforts were delayed by the need to review cases for grand jury material and to review matters for possible jurisdiction of the Office of Labor Racketeering. You have asked that I review these cases and make appropriate recommendations as to their disposition.

DISCUSSION AND RECOMMENDATIONS

In your memorandum of September 19 to Inspector General Hyland, you requested information as to the size of the universe of cases affected by the OLC opinion. This information would, of course, be useful in attempting to plan for their orderly disposition. I realize that there has been considerable discussion concerning a 1200 case figure. Based on my conversations, the OIG draft Semiannual Report, and additional materials supplied to me by the OIG on November 6, it appears, however, that many of these matters have already been disposed of in a number of ways.

The draft Semiannual Report, which was transmitted to you on or about October 18, notes that 315 cases have been closed. As to these cases, presumably no further action is required. An additional 42 files involved joint cases in which the cooperating agency assumed responsibility. Another 356 cases involve investigations which have already been completed and are awaiting prosecutorial action. There are 108 cases in which United States Attorneys have requested OIG to continue its investigations.

As a result, there are 371 cases which we have considered, based upon the OIG's determinations. The Semiannual Report makes reference to these 371 cases in two categories. These are the 85 cases which had been referred to the Department of Justice and 286 cases which the OIG had determined are appropriate for referral to DOL program agencies. The total number of cases in these two categories is 371. It is our understanding that these are the same cases as those shown in the table submitted to me by the OIG on November 6.

You have asked for advice as to the proper handling of these cases and whether there are matters which are clearly within the OIG's investigatory jurisdiction. As noted above, the actual case files are currently in the possession of the OIG, and I have not examined them. On the other hand, prompt decisions on the handling of all these matters will facilitate the continuation of these investigations so that they can go forward without delay. I am therefore making the following judgments based on the November 6 table provided by the OIG which categorizes the 371 cases which the OIG has determined to be outside its investigative authority.

Two categories of cases involve Black Lung matters. They are "CMWC Claimant Fraud" and "CMWC Provider Fraud". These two categories include 17 files. These files may be retained by the OIG for any further appropriate investigation, based on our understanding that they involve claimant or medical provider fraud affecting the Fund. If there are any cases involving substantive violations of the Black Lung Act or involving the incorporated provisions of the Longshore Act, these cases would need to be examined individually for the purposes of determining the appropriateness of continued IG investigative activity under the OLC opinion.

Two categories of cases listed in the table relate to unemployment insurance matters. They are "UIS Fictitious Employer Scheme" and "Claimant Fraud (R Ben, EB, FSC)." The total number of cases in these categories is 285. These matters should be further screened by the OIG. To the extent that the cases referred to under the above-quoted categories involve only regular unemployment insurance benefits, those cases should be transferred to the Employment and Training Administration so that they may be referred to appropriate state authorities for any necessary further investigation. Fraud cases involving the Extended Benefit (EB) and the various Federal Unemployment Insurance programs may be retained by the OIG.

Two cases are indicated under a category entitled "Other" and there is another case which has no identifiable category. It is not possible to make a judgment about these matters without further description or an examination of the files. You should request the OIG to further define these cases.

The remaining cases are included under the following categories: "LHWCA Claimant Fraud", "Wage & Hour Programs Fraud", "ERISA Health Plan Fraud", "Pension Plan Fraud", and "USES Alien Certification Fraud". The combined number of cases in all of these categories is 66 cases. These matters should be referred to the appropriate DOL program agencies for further action.

In conclusion, we have reviewed the November 6 table of 371 cases prepared by the OIG. We have concluded that as many as approximately 300 cases can be retained by the OIG. Upon further analysis of the cases, some of these matters may have to be referred to the states for their investigatory action.

I recommend that you advise the OIG of my conclusions. I further recommend that you bring these matters to the attention of the Executive Staff and urge that prompt and necessary actions be taken to facilitate retention of files by the OIG in appropriate cases and transfer to the program agencies in other appropriate cases, as set forth above.

Mr. HUGHES. Also, the record will remain open so Mr. Maria can submit for the record a breakdown of the 1200 cases so we can take an independent look.

[The following information was subsequently received from Mr. Maria:]

In light of the OLC opinion, the following kinds & numbers of cases, as mentioned in our Semiannual Report, will become "inactive":

Unemployment Insurance Program cases		
	Claimant fraud (primarily State funds)	982
	Embezzlement & fraud (primarily State funds)	11
ESA:	Wage & Hour Programs, fraud & abuse (i.e., Davis-Bacon & related Acts)	157
	Coal Mine Workers (Black Lung claimant/beneficiary fraud; Black Lung medical/legal provider fraud)	49
	Longshoreworkers claimant/beneficiary fraud; medical/legal provider fraud	21
	OFCCP Programs, fraud & abuse	1
MSHA:	Vendor/Mine Operator/Owner fraud & abuse	1
OSHA:	Grantee/Vendor fraud & abuse; OSHA fraud & abuse (State/Other programs)	7
PWBA:	ERISA health plans, fraud & abuse; ERISA pension plans, fraud & abuse	15
Alien Certification Program, fraud & abuse		20
		1,264

This number includes pending as well as freshly opened cases.

Mr. **Hughes**. How do you respond? What are you doing about the first point, relating to the coordination of the four parts of the Department of Labor that have information that relates to employee benefits?

Mr. **Ball**. Well, I understand, Congressman, that in the past, there may have been some personality differences that led to lack of cooperation. I want to assure you that I have met frequently with the other ERISA agencies. I have met frequently with Ken Gideon, Assistant Secretary of Treasury for Tax Policy, Jim Lockhart, head of the PPGC. We talk on the phone and exchange information. I have never found an aura of greater cooperation. I suspect it will assist us in the effort as will cooperation with the Acting Inspector General.

Mr. **Hughes**. I think there should be a strategy at the Department of Labor which works toward assuring employees that their benefits are protected. The department should be letting Congress know what you think you need in the way of resources. If we don't give it, that is our problem; but at least you should be telling us. I don't know how we will resolve the problem of the Inspector General and the criminal investigations.

Mr. **Lebowitz**. May I add a word or two to Mr. Ball's answer? The two principal agencies are the Labor Department and the IRS. We have very extensive communications and formal relationships with the IRS so that literally masses of information pass daily on a local level between our enforcement people and their's.

Our investigations are coordinated to make sure, one, that we don't trip over each other or harass people and B, that we get the broadest possible coverage. We have other very positive relationships with other agencies like the five Federal banking agencies and the SEC who regularly provide us with information when they come across something that they believe constitutes an ERISA violation. When we get those references, we do follow up.

Mr. **Hughes**. What you say in essence is that you do a good job of talking to other agencies, you just don't talk among yourselves. The gentleman from Florida.

Mr. **James**. First, I want to thank you for your testimony, all of you. You have been very candid with the facts and have stepped out and made statements that take courage. I appreciate that.

I want to ask questions that will be to the point and hopefully they are tactful, but I am trying to get to a specific point. I see you have 1672 civil investigations, Secretary Ball, our of 870,000 cases; is that all you had in 1987, for example, 1672 investigations?

Mr. **Ball**. We currently have 1670 investigations with regard to 900,000 plans, yes.

Mr. **James**. How are those initiated; by complainants?

Mr. **Ball**. They are initiated in a variety of ways, either through computer analysis, which is coming on the street now. They are initiated by referrals from other agencies such as IRS or Federal or State agencies by claimants, by participants, or even by reports in the media.

They are initiated in a variety of ways.

Mr. **Lebowitz**. About one-third of cases are based on computer analysis.

Mr. JAMES. Thank you. We have limited time. I see you only had 24 indictments out of 48 criminal investigations in 1987. Well, it says in fiscal years 1987 and 1988 you got only 24 indictments, which doesn't necessarily mean successful prosecutions; is that correct?

Mr. BALL. I believe that is correct. I would like to add, however, that it is my understanding that with the use of the new computer system and with the cooperation we are receiving from the Inspector General and the new tools that we have, that the Secretary and I intend to come down with hobnail boots on criminal violators.

Mr. JAMES. Yes, that is fine. That is a very small number of criminal investigations, infinitesimally small, wouldn't you say?

In other words, about as much chance as you would have of winning the lottery as you might be indicted. You might make that comparison. I think it is a little better than the Florida Lottery to win $10 million. You cannot say that is a significant part of your function, the criminal investigations to date.

Mr. BALL. The past record is what it is. I have been here 2 weeks. I don't wish to walk away from the past record. I think the department has done a good job with the limited resources it has had in the criminal area. I do agree that there is room for improvement.

Mr. JAMES. We would not talk about it in Congress if that is reflective of the criminal acts that are occurring. That would be infinitesimally small with regard to that many plans. In fact, 1600 civil violations, you don't count failure to file a report properly or on time, is that a grounds for an investigation?

Mr. LEBOWITZ. No, sir, it is not. Each of these cases represents a full review of the operations of a plan for something like of somebody who may be providing services to hundreds, maybe thousands of plans. So as we testified previously each of these cases we tried to magnify its impact.

Mr. JAMES. Wouldn't it be better, Secretary Ball, if in fact because you only have 70 investigations, wouldn't it be better if we made the laws perhaps more stringent or more strict as to where you can investigate it so the IRS could monitor, for example, the plan as to qualifications at the time of the filing of the tax return to minimize the expense to the department and, say, investments can only be made in specific areas? Would that be a major problem?

Mr. BALL. IRS has its own sections of ERISA which it does enforce vigorously.

Mr. JAMES. I misunderstood. Should we look at the number of places where these funds could be put and develop laws that would require certification of trustees or if not, trustees people who function that way, function to provide services?

Mr. BALL. ERISA has very, very rigorous standards with regard to investment and the behaviors of fiduciaries and investment managers. The standards are there. I don't think anybody questions the toughness of the standards.

What we are talking about really is the enforcement effort.

Mr. JAMES. Let me ask Mr. Maria a question.

You made a comment that you did not understand the Working Group making the statement that criminal prosecutions, putting the emphasis on that would interfere with voluntary cooperation.

Do you not recognize that as a problem when you are facing criminal prosecution, that you may very well take the Fifth Amendment for fear of being incarcerated and obviate the need for money?

Do you think that is a valid concern?

Mr. MARIA. The term "voluntary compliance" puzzles me. You decide to comply only when caught. The issue is to deter people from committing the violation in the first place. The question should be when confronted with facts and circumstances suggestive of an abuse or corruption, evaluate those within the context of how they occurred, and then determine what the method of redress should be and what the punishment should be to address the crime.

Conviction requires proof of guilt beyond a reasonable doubt. You can still pursue it civilly, which requires only a preponderance of the evidence, and you can use the civil conviction as part of the preponderance of evidence.

Mr. JAMES. I under the distinction between civil and criminal law.

Mr. MARIA. I did not mean to lecture.

Mr. JAMES. I also understand that in a criminal case, criminal defense attorneys specifically instruct their clients to say not a word. If they say a word, even though they will not cooperate until the criminal prosecution is completed, you would be foolish to say a word to anyone related to the civil indictment.

Wouldn't you agree?

Mr. MARIA. I would agree.

Mr. JAMES. Even though all of us agree that there is a place for criminal prosecution which should be pursued with vigor when there is evidence of fraud, you can also understand the concern for the approach to be emphasized when it would interfere with the ability to collect money or at least put it off for some time. So that is a real concern, not imaginary; is it not?

Mr. MARIA. I would not disagree with you at all. It is a real concern. I would like to put it into a context. Given the limited resources we have in the Office of Investigations, I am not asking for more people. I want that to be abundantly clear, given the limited resources we have and the fact that we have not deployed all our resources in the Office of Investigations in the area of benefit plan abuse, as a practical matter, we would probably be talking about 10 criminal investigations a year, 10.

How would that impact upon the large number of civil investigations instituted by the Pension and Welfare Benefits Administration? I think it would add a lot to deterrence and send a signal to the regulated community that if you do things beyond a certain point, we will look at you from a criminal standpoint. Ten investigations a year?

Mr. JAMES. I would consider 10 insignificant. If the evidence of crime and fraud is as high as you say it is, I would expect prosecutions in the thousands, not the tens, if your assumptions are correct, which leads me to my final question. Do you intend to investigate these 1600 civil cases to see if, in fact, there is substantial evidence that criminal fraud or substantive violations of the law that should be criminally enforced?

Mr. MARIA. No, I have no intention of doing that. Remember, the Office of Investigations is precluded and the Office of Labor Racketeering has its well established short- and long-term investigative agenda.

Mr. **James**. If the Inspector General cannot got these specific facts of lack of criminal prosecution with regard to those civil cases, how can I as a congressman render a competent opinion as to whether or not they are, in fact, doing their job other than using some kind of generalized deductive logic?

Mr. **Maria**. I think what would be required is a thorough analysis of those cases to determine whether or not the correct policy decision was made in determining whether it should have been pursued along the civil investigative route or a criminal investigative route.

Mr. **James**. And the Inspector General is not the office to do that?

Mr. **Maria**. No, I don't believe we are the office to do that.

Mr. **James**. Who is?

Mr. **Maria**. Perhaps the General Accounting Office might be willing to undertake that in terms of looking at a sample of those cases.

Mr. **James**. Would that be the administration's responsibility to ask a specific office to look into those matters?

Mr. **Maria**. I think it would be Congress' responsibility to make that request.

Mr. **James**. To the administration. Considering the separation of powers we might make that request and see what happens or the President or the administration or you could make a recommendation to the President in fact, could you not, within the Executive Branch, and produce evidence that would act as a guide to the Department of Labor?

Mr. **Maria**. With all due respect, Congressman, I believe that would not be productive nor would that be an effective utilization of the limited number of people that we have.

Mr. **James**. I feel that Congress might ask for information. It would seem that the Executive Department could—

Mr. **Hughes**. Would the gentleman yield to me?

It would be very appropriate for this subcommittee to make that request to the General Accounting Office. That is something we will consider, and we will talk about that later.

Mr. **James**. If you specifically made that request, I think we could analyze it and see where we are. I am concerned about the small plans, as well as the big plans, most concerned. There is $1.87 trillion out there, and we don't know how much fraud and corruption we are going to face.

How close is it going to be to the S&L crisis? This is related to the S&L crisis. Some of those funds may have been put into the savings and loans which may not have been insured. Otherwise, healthy plans might have been jeopardized because of the $100,000 limitation; correct?

Mr. **Maria**. I would not disagree.

Mr. **James**. Even super healthy small plans, small business plans with one trustee and five or 10 employees maybe, every one in good faith thought they were being properly serviced.

The danger is not with the trustee or the employer, always. It is a lot of time in the servicing agents and the services that are charged and when the employer or employees are told funds are on deposit with such and such an institution and you find there is not sufficient capital or backing in those institutions, that is wherein the problem might lie.

Mr. **Maria**. I think your comments go to the very heart of the recommendations with respect to the removal of the exemption which prevents a limited scope audit.

Mr. **James**. You cannot get a CPA without doing an audit of the institutions which is a super procedure which no small trust plan could ever afford. If you had your monies deposited in an uninsured or even an insured savings and loan association or bank, if you required an independent audit of those people holding those funds, that would be prohibitive. So you don't suggest that.

Mr. **Maria**. I am an accountant and a member of the American Institute of CPAs. I would contest the premise that what we are asking for in terms of the removal of the limited scope, what we are asking for with respect to the compliance auditing, and we are working on these proposals with Mr. Ball, I would say this is not a super expensive procedure.

Mr. **James**. Expensive with relation to the income coming from those plans. In the small plans, it might be fairly expensive unless you had it on certain kinds on institutions.

Mr. **Maria**. Plans with fewer than 100 participants are not required to have an audit.

Mr. **James**. Those are sometimes the ones that need the observation as much as the bigger ones or more.

Mr. **Maria**. More so.

Mr. **James**. Because there are more of them out there.

I have run out of time. Thank you so much. You have been very helpful.

Mr. **Hughes**. Thank you.

The gentleman from Illinois.

Mr. **Fawell**. I have some comments.

It seems at times that bad news is the only news that is printed. I don't criticize you for expressing yourself as you have. You have seen a situation, and I think it has been brought out here abundantly that there is the potential for fraud and that you, in fact, have said you are assuming that there is a lot of fraud there that actually would require criminal penalties being meted out. I guess the bit of a problem that I have is the fact that we overlook, as we often do, that ERISA has been a fantastic success in this country; and it is one of the few areas in the country where Congress has allowed preemption to take place. There are a number of areas that are covered.

The first question I have—Mr. Ball, you might be more appropriate to respond; don't you believe that we ought to be indeed enlarging ERISA to that, even perhaps public pension funds ought to be under ERISA? A lot of us would feel a bit better about the potential of fraud if that were so.

Mr. **Ball**. I understand, Congressman, that historically the States—I think we are talking primarily about State public pension plans. They have resisted the application of ERISA. I would think that they would benefit from ERISA standards. I agree with you that ERISA has worked well. It has been very successful. Of course, there is room for increased vigilance, and we are going to see to that. It has worked well, and the States would benefit from similar types of laws. I am not sure whether under our constitutional system whether the Congress can impose on the States ERISA standards for public funds.

Mr. Fawell. If we are assuming this, certainly as everyone has indicated, there is the potential for fraud, no question about that and therefore, the potential need for deterrence. But in terms of when one looks at ERISA—and I don't want to be Pollyannish about it, recognizing there have been a lot of positive things occurring, I can think of only one area where one could best look to see if there is this fraud and that is in the failures of those plans that have occurred.

In one of the large ones PBGC has been involved in—and it means the taxpayers may have come up with a lot of money to rescue these funds. The failures, especially those PBGC has been involved with, is there evidence of a great deal of fraud that has brought about these failures?

Mr. Ball. No, sir there is not. I think you are referring to cases like LTV, which have generated huge liabilities for the Pension Benefits Guaranty Corporation. They did not result from fraud and embezzlement. They resulted from the actuarial rules that existed at that time. Congress has since tightened and toughened the rules with regard to funding so that that kind of systematic underfunding is not likely to happen in the future.

Mr. Fawell. I think we might bear in mind, although I think, obviously, it is good if we have the money and if we have the number of personnel that could go into a much better job of policing because perhaps we may be facing these problems in the future. It is good for us to remember, though, that a ERISA has been an outstanding success.

Again, I don't want to be Pollannish about this, but I can only state that there are assumptions and there are fears and there is need for potential deterrence and to overlook at least in those cases we know of where there have been massive failures, it has not been a result of fraud. I think I will enter just one bit of positive statement into the record. I thank all the witnesses for yourself. I appreciate Mr. Maria, your comments. I don't mean to imply that they should not be made.

As a person with a criminal investigative background out of the FBI, and so forth, I can understand the frustration you might have that not enough is being done with regard to vigorous criminal prosecution. We ought to have these tools. Thank you, Mr. Chairman.

Mr. Hughes. I thank the gentleman for his very balanced statement. I, too, would reiterate what the gentleman has indicated and others have said today that the vast majority of pension plans and benefit plans in this country are well run where there are no problems and we need to keep it in perspective. The gentleman from Florida?

Mr. Stearns. Thank you, Mr. Chairman. I want to compliment you for holding these hearings. I am sorry I got here a little later.

I could not agree with you more. I want to thank the witnesses for coming and particularly for Mr. Maria for his courage to be so forthright and speak candidly. I have two questions before we break. I sat through 100 hours of the S&L crisis and now we are making up the HUD. When you see large sums of money like this you wonder if there are enough controls involved. We have been involved in the S&L crisis and HUD crisis there were flaggings.

When I come to this hearing I am also sensing that there is not sufficient effective control systems and that the penalties are sort of minor and maybe we should be concerned. The questions I have related to the Pension Benefit Guaranty Corporation.

Mr. Ball, would you recommend any changes in that area or do you think as we stand now that it is sufficient to cover any fraud and abuse for the benefit plans? What is your feeling in that area?

Mr. BALL. I would like to point out first of all that the Pension Benefit Guaranty Corporation is a separate corporate entity. They report to the Secretary of Labor but not through me.

Having said that I think the most important matter about the PBGC at this time is the fact that the Supreme Court has accepted certiorari in the LTV case. That involves the issue of follow on plans and whether or not the government will be stuck with a $2 billion liability. I would think if for any reason there was an unfavorable decision in that case then the Congress would certainly want to consider acting.

But it may well be that the Supreme Court may uphold the position of PBGC in that case so they will not be left holding the bag of almost $2 billion in liabilities that ultimately go back to the taxpayer.

Mr. STEARNS. Mr. Maria, I wanted to ask you about what you see as a scenario. If you will project with me, based on what you see today, we have the amount of money increasing in pension funds yet the number of actual investigations is going down. What do you see in the next 2 years? Take me through your mind's eye of different things that could happen which would be the scenario if we do not take further steps in your opinion?

Mr. MARIA. I see a number of things happening. I think we see an increase in the number of pension plans that are defined contribution plans as opposed to defined benefit plans. Defined contribution plans are not insured by the PBGC so arguably there is some exposure there. I don't envy Mr. Ball, given these numbers. Given these numbers, as we have said, really a limited number of investigative personnel always be confronted with that.

The tactic is to do as well as you can with the limited number of people you have, focus on the areas of greatest abuse. That requires, I think, a comprehensive strategy within the department, taking advantage of all those agencies that impact on benefit plans and pulling together the relevant information so, in fact, you are addressing established priorities and you are addressing the most egregious offenses. That has yet to be done.

Mr. STEARNS. Do you sense any urgency that Congress should be doing something?

Mr. MARIA. From a personal standpoint, absolutely. We have here an opportunity to probably deploy an additional 35 to 45 investigators in the area of benefit fraud. I guarantee they will not duplicate anything else that is occurring but right now we are hamstrung.

Mr. **Stearns**. Thank you.

Mr. **Hughes**. I thank the gentleman.

We are going to break now until 12:30 p.m., because there is a joint session of Congress to receive a message from Lech Walesa.

I would like to ask you if you might submit for the record specific recommendations on how Congress might deal with the limited scope problem, and how we might deal with the problem that obviously is going to accrue relative to the plans that are presently exempt from the most stringent requirements, those plans with less than 100 workers.

Mr. Ball, how can we possibly do some restructuring within DOL to make sure that all the information we have available from all agencies, within DOL as well as outside DOL, can be assembled and collated in a central commercial house fashion so that we can maximize our resources?

Also, I'd like your suggestions at this point on how we can get a better handle on the scope of the reporting problems. I suspect a lot of the reporting problems the Inspector General has alluded to are just failures to report the information such as characterizing a question dealing with financial information as not applicable. If you can do that, the record will remain open for a period of 10 days and we appreciate it.

Mr. **Ball**. We will do that Mr. Chairman, thank you.

[The following information was subsequently received from Mr. Ball:]

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210

DEC 6 1989

The Honorable William J. Hughes
Chairman, Subcommittee on Retirement, Income
and Employment
House of Representatives
714 House Annex 1
Washington, D.C. 20515

Dear Mr. Chairman:

During the Subcommittee's November 15, 1989 hearing on ERISA enforcement issues, you requested that I submit to you responses to a number of questions you raised at the conclusion of my testimony. I am pleased to respond to your request.

Enclosed are the answers to your questions. I hope these responses prove helpful to your Subcommittee. If you have any further questions, please feel free to contact me.

Sincerely,

David Ball

David Ball
Assistant Secretary

Question 1. How should the problem of limited scope audits be addressed?

Answer: The Department has stated (in its September 18, 1989 letter to Congressman Lantos concerning ERISA · enforcement) that the Department believes it may be appropriate to eliminate the limited-scope audit exception. We recognize that this may result in an increase in plan audit costs. The American Institute of Certified Public Accountants estimates that the elimination of the exception may result in an increase in audit costs of 10 to 30 percent. Such costs will be borne, either directly or indirectly, by the plan.

We also recognize that a high percentage of plans use the exception, and that the present regulatory climate for banks and insurance companies is different and often less reliable than that which existed when ERISA was enacted. We are currently engaged in a study to determine whether the limited scope audit exception should be eliminated. The focus of this study is on: (1) the potential benefits to be gained from requiring a full scope audit in place of a limited scope audit; (2) the additional cost which would be imposed on plans as a result of the elimination of the limited scope audit; and (3) the additional processing burdens which would be placed on banks and insurance companies due to the elimination of the limited scope audit.

We are also examining whether the benefits of a more comprehensive audit, while keeping increased plan costs to a minimum, may be achieved by the "single-audit approach." Under this method, the plan's Independent Public Accountant (IPA) would obtain a special-purpose report from the bank's or insurance company's independent auditor. This report would provide assurances that the necessary procedures and review of internal controls of the bank or insurance company have been performed. Those assurances, when coupled with the other auditing procedures performed by the plan's IPA on transaction information, would enable the IPA to render an unqualified opinion on all assets listed on the plan's financial statements.

In our continuing efforts to address issues and review proposed changes concerning limited scope audits, we have met with representatives from the Office of the Comptroller of the Currency and the

Federal Reserve System. Other meetings are planned with the American Bankers Association, the American Council of Life Insurers, and other representatives of the industries directly affected by the proposed changes.

Question 2. What should be done for plans with less than 100 participants?

Answer: There are at least two conflicting policy goals in the small plan area. On the one hand, we would like to expand pension plan coverage among small firms. Small employers are much less likely to offer pension plans to their workers than larger employers. On the other hand, there is always a greater potential for problems to exist with small plans because they do not have the resources to pay for sophisticated legal, accounting and other advice. There is a need to achieve a balance between having requirements that will help protect that small universe of plans that have problems, and ensuring that those requirements will not put undue financial burdens on all small plans and discourage expanded coverage.

The balance that has been struck is to provide for simplified reporting for small plans, including exempting them from the requirement to have an audit performed by an Independent Qualified Public Accountant (IPA), because the cost of fuller reporting and IPA certification would outweigh the benefits to be gained by these plans. Whether this balance is an appropriate one is being reexamined as part of our enforcement review.

In addition, as part of its enforcement strategy implementation program, the Department pays particular attention to investigations of service providers to plans as a way of magnifying its impact, as one service provider may provide services to hundreds of small plans.

Question 3. Steps the Department can take to ensure that all information concerning enforcement issues can be assembled and coordinated in a central fashion.

Answer: The Pension and Welfare Benefits Administration (PWBA) and the Office of the Inspector General/Office of Labor Racketeering (OIG/OLR) have been operating under a joint Memorandum of

Understanding since March 1980, to improve the effectiveness of the Department's enforcement activities in relation to organized crime and racketeer infiltration, control, and influence in the employee benefit plan field. OIG/OLR and PWBA have agreed to exchange information in investigations involving matters of interest to both agencies. On a quarterly basis, PWBA provides OIG/OLR with a list of all benefit plans targeted for audit (within the following 90 days) which are affiliated with unions within industries identified by OIG/OLR. In addition, upon request, PWBA will provide OIG/OLR with a list of all matters currently under investigation by PWBA which can reasonably be considered to contain matters within the jurisdiction of OIG/OLR. Such matters consist of investigations which involve individuals reported to be affiliated with organized crime and matters in which OIG/OLR has previously expressed some interest. When requested by OIG/OLR, PWBA furnishes additional materials which may be of investigative assistance, such as computer printouts of reporting benefit plans and information from its investigative files.

PWBA has a Memorandum of Understanding with the federal financial institution regulatory agencies -- Federal Reserve Board, Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, and National Credit Union Administration -- by which these agencies refer to the Department suspected ERISA violations arising out of their audits. PWBA has been provided a computer tape of filings showing amounts invested in various categories of assets by these institutions in accounts over which the institutions had discretionary investment authority. PWBA has also obtained access to portions of the audit reports by these federal agencies of specific banks that are the subject of PWBA investigations.

PWBA has a coordination agreement with the Internal Revenue Service (IRS) which establishes procedures which apply to all civil examinations conducted by PWBA and IRS. In addition, the two agencies may use special procedures where appropriate, including joint investigations. In January 1989, the Memorandum of Understanding with the IRS was amended to establish a better system for tracking referrals between the agencies. An essential rationale for this coordination program is that the IRS has statutory and regulatory tools, not available to the Department, which enables it to impose an excise tax on prohibited transactions relating to pension plans, and recover plan losses. Meetings are regularly held between the IRS district offices and PWBA field offices to discuss referrals and other matters, and special meetings are held whenever necessary to coordinate investigative activities in specific instances.

The Securities and Exchange Commission (SEC) has procedures governing grants of access to the Commission's nonpublic enforcement and regulatory files. PWBA receives enforcement related information from the SEC and has not had any difficulty in obtaining access when such a request is made.

PWBA and the Department of Labor's Office of Labor Management Standards (OLMS) are conducting a one year pilot program of interagency referrals between two of our field offices. A checklist is prepared by PWBA investigators in conjunction with each investigation involving a Taft-Hartley plan. The information on the checklist is then provided to OLMS, which can then determine whether to open its own investigation on the union. Likewise, OLMS investigators prepare a similar checklist during their union investigations, and the information is used by PWBA to target appropriate investigations. The Department also meets with the Pension Benefit Guaranty Corporation on matters concerning pension issues when appropriate. We are examining ways to better coordinate with other appropriate agencies within the Department of Labor.

Coordination with state and local agencies is the responsibility of each PWBA field office. As a result of PWBA's increasing involvement regarding financial institutions, field offices have established working relationships with their counterparts in state banking, insurance, and securities agencies. PWBA field offices have entered into information sharing agreements with the various state banking and insurance commissioners which provide for the sharing of information obtained under their respective statutory authorities.

A Memorandum of Understanding entered into between the Secretary of Labor and the Department of Justice provides guidelines for the investigation of criminal matters related to ERISA. Although the Comprehensive Crime Control Act of 1984 conferred on the Secretary of Labor independent authority to investigate criminal violations relating to employee benefit plans, PWBA field offices routinely confer with the local U.S. Attorney's office about specific criminal cases.

Question 4. Suggestions for addressing reporting problems, (e.g., enforcement regarding items that are disclosed on the Form 5500).

Answer: The Department of Labor is currently in the process of implementing a program to ensure that all of the information required to be disclosed on the Form 5500 is provided in a complete, accurate and timely manner. The program reflects a general policy on reporting which seeks disclosure on Form 5500 only of information which is useful for enforcement of ERISA, and which emphasizes providing assistance to filers to facilitate voluntary compliance with reporting requirements, and which imposes civil penalties in cases where plan administrators fail to file or file a materially deficient annual report.

The reporting compliance program is comprised of three parts. The initial aspect is a program of public outreach and assistance in completing the forms. A pamphlet outlining the reporting requirements, the most common deficiencies and how to correct them was developed and mailed to all Form 5500 series filers in March. This was followed by the provision of PWBA staff to conduct seminars on filing requirements for various groups which had expressed an interest in participating in the program. PWBA staff has also been made available by telephone to answer questions regarding the proper completion of the forms.

The second component is the automated screening of filings after they are received by the IRS and the generation of correspondence with all filers with errors or omissions. The IRS Service Centers, which receive the filings, key enter all of the data and subject it to a series of approximately 130 automated edit tests to determine whether all of the required information is present. In cases where deficiencies are found, correspondence is generated to the filer providing notification of the deficiency and requesting that it be corrected. If the deficiency is not corrected within 30 days a second letter is sent, followed by a third after an additional 30 days. This system began operating in July, 1989 with the early experience indicating that nearly 90% of the deficiencies are corrected as a result of the first letter.

For filings with deficiencies remaining after the three rounds of correspondence, civil penalties of up to $1,000 per day may be imposed under the authority provided in section 502 (c)(2) of ERISA. This new statutory authority applies to all reports due after January 1, 1989. It requires that the report be rejected by PWBA as deficient and the filer be afforded an additional period to correct the deficiency. If the filing is not corrected the civil penalties may be assessed and an independent accountant may be engaged by DOL to produce an acceptable report. PWBA is currently in the process of implementing this program, which should begin operation in January 1990.

Mr. **Hughes**. You must look back at your duties at AMEX as a cake walk after 2 weeks on the job with the Pension Welfare Benefits Administration, Mr. Ball. In any event, we appreciate your willingness to come testify today even though you are relatively new on the job. I think it is a great opportunity for you to provide the leadership that is obviously needed to work together with the Inspector General's Office and others to try to deal with what potentially could be a serious problem.

Mr. **Ball**. I look forward to working with you, thank you.

Mr. **Maria**. Thank you, Mr. Chairman.

Mr. **Hughes**. The subcommittee stands in recess.

[Recess until 12:30, the same day.]

AFTERNOON SESSION

Mr. **Hughes**. The Subcommittee on Retirement Income and Employment will come to order. I want to apologize for the interruption. As you know, we had a joint session of Congress today and we had to break for that.

I am happy to welcome this afternoon's panel, particularly Mr. Paul Friedman, a member of the firm of DeMaria, Ellis and Hunt, located in Newark, New Jersey, where he specializes in the litigation aspect of employment law representing both companies and employee benefit plans. Since 1980, he has represented approximately 23 separate multi-employer benefit funds in litigation arising under ERISA. He is a graduate of Rutgers College, my alma mater, and the University of Maryland School of Law.

Prior to becoming involved in employment law, he served for 2½ years as an Assistant Essex County Prosecutor in the Essex County Prosecutor's Office in New Jersey. At the present time he serves as a member of the Executive Committee of the Labor Section of the New Jersey State Bar Association and has served as the ERISA and Benefits Coordinator of that Section since 1987.

We are delighted to have you with us.

Another member of the panel is Don Holland, Assistant Director of the Administrative Law Section for the State of Georgia Insurance Commissioner. He will discuss enforcement problems he has encountered at the State level with ERISA-covered health and welfare plans.

We welcome you.

The subcommittee also welcomes Mr. Andrew Capelli, National Director for Litigation Support Services for the American Association of Certified Public Accountants.

In his role as an engagement partner for the financial services industry, Mr. Capelli is responsible for meeting the needs of investment bankers, securities and county brokers and investment advisers plans.

We welcome you.

Mr. Thomas Walker is the President and CEO of the Associated Benefits Corporation, an Iowa not-for-profit corporation. They are an employer for over 300 benefit plans. We have received your statement.

Without objection, they will be made a part of the record in full. We hope you can generally summarize for us. Let me begin with you, Mr. Friedman.

STATEMENT OF PAUL A. FRIEDMAN, ATTORNEY, DeMARIA, ELLIS & HUNT, NEWARK, NJ

Mr. FRIEDMAN. Thank you, Mr. Chairman. I want to thank you for the opportunity to speak on behalf of the participants and beneficiaries of both the Local 109 Retirement and Welfare Fund. I believe that the situation which both these funds encountered pretty much takes us from the abstract concepts which we were discussing this morning to a more concrete situation.

In this situation, we had a small pension fund and a small welfare fund which administered to the needs of waiters, waitresses and kitchen help within the vicinity of Newark, New Jersey. None of these people made a lot of money. None of these people would have received large pensions. None of these people would have received great medical benefits. But as a result of the pilferage of these funds, these people stood to lose everything.

In 1982, these combined funds had assets of $1,542,000 as of the filing of the last Form 5500 which was filed for a number of years on 12/31/82. If these funds had not been pilfered, the estimated financial position of the combined assets of the funds as of 12/31/85 would have been $1.7 million. When I was hired by the present Board of Trustees of these funds in March of 1986, there was $25,000 remaining of combined assets of both these funds.

This is not a case, Mr. Chairman, in which there was sophisticated manipulation of monies. This is a case in which, based upon the way the system worked, a small group of individuals were able to literally loot the funds as they saw fit. In 1981, an individual by the name of James Carl Benjamin, whose prior experience had been as an itinerant dishwasher in the Newark Board of Education became President of Local 3 of the Hotel and Restaurant Employees Union.

Local 3 had been created as a result of a formation of Local 109 and Local 131. Obviously, in the Newark, New Jersey area there was declining membership due to the closing of many businesses. The resulting organization, Local 3 had members who were primarily employed by the Newark Board of Education. Pursuant to the collective bargaining agreements with that entity, there were no contributions made to the Local 109 retirement or welfare funds on behalf of the members of Local 3 who were employed by the Newark Board of Education.

These were covered in other ways. However, the minority of the membership of Local 3 remained as the former Local 109 members. Pursuant to collective bargaining agreement which had been intact for a number of years, contributions continued to be made by the contributing employers to both the Local 109 Retirement Fund and the Local 109 Welfare Fund. The majority of the people affected by this were people in their sixties and seventies who worked for a pittance their whole life and relied upon the medical coverage and the pensions from these two funds.

Within a year after Mr. Benjamin became the President of Local 3 and as a result, based upon his status as President of Local 3, he also served as a trustee and administrator of both these funds. Mr. Benjamin apparently realized that there were no restraints upon him, that if he could talk one or two other individuals into engaging in a scheme with him, they could have a field day which is exactly what they did. Between 1982 and 1986, Mr. Benjamin and his cohorts saw to it that the fund's professionals, accountants, actuaries and attorneys either were fired or quit. Trustees meetings were not held for a period of 2 years while Mr. Benjamin and his cohorts looted the funds.

Could they have done this alone? No. Trustees could not have done this alone. Along with Mr. Benjamin was an individual named James Wellington Brown, a Vice President of Mid-Atlantic National Bank located in Newark, New Jersey, and other cities throughout the State. Invested with that bank were about $1 million of benefit fund assets belonging to both the retirement fund and the welfare funds.

Over a period of 3 years, Mr. Benjamin, Mr. Brown and another trustee, Mr. Pannullo, systematically removed from that bank all the assets of the Local 109 Retirement and Welfare Funds. In some instances Mr. Benjamin was so unsophisticated that he took a Local 109 Retirement Fund check and drew it directly to the Big Man's Shop to buy $3,000 worth of clothing for himself. In another instance, he paid for a diamond ring for his bride and there is a strong possibility he paid for his wedding reception. Fortunately, he could not get the Drifters to appear, so we saved a few bucks.

Mr. Benjamin, along with Mr. Brown, had individuals who had no visible means of support go to the Midlantic Bank and apply for loans ranging from a few thousand of dollars to many thousands of dollars. These people had no jobs, no collateral. What was the collateral were the certificates of deposit belonging to both benefit funds on deposit at the Midlantic National Bank. This went on for a period of years. Other banks were equally liberal in their lending policies to Mr. Benjamin's crew. These banks were aware that money could only be removed on dual signatures.

There were instances where monies were removed on single signatures. There were instances where these people of no means went to the banks, applied for loans and somehow the loan committees of these banks were able to use as collateral, Local 109 Retirement Fund CDs, and Local 109 Welfare Fund CDs, where on its face there was no relationship between those people and these entities but the money went. The banks were always repaid because when the loans were not repaid, the banks went against the collateral. So as a result, by the early part of 1986, there was very little money left in the funds.

Ironically, one of these banks that had permitted cross-collateralization of various assets, when we went there, Mr. Zayas—and one of the important things to consider in this case and there was some question this morning about using private accountants to do some of this audit work, the only reason these funds are functioning today is because I had the good sense to hire an investigative accountant, I hired Ricardo Zayas. As a result of Mr. Zayas' cooperation, we were able to trace these defalcations backward and come up with a number to at least start to resurrect these funds.

In addition to the pilferage of the funds, the funds had been exposed to several third party actions as a result of breaches of fiduciary duty by the trustees. Financial institutions have been pursuing the funds. Participants in this welfare fund whose medical claims were not honored because premiums were not paid are being sued. They are pursuing the funds. So when you look at the picture of the Local 109 benefit funds, the tragedy is not limited to what was taken. It is also extended to the additional exposure which these funds must face now. There was approximately $1.7 million stolen, but as of the most recent calculation, based upon the law suits out there, the losses are closer to $2 million.

The criminal investigation, and there was one, and in this case I disagree with some speakers this morning, I believe the criminal investigation was done very well. I believe they got in, did what they had to do, and spearheaded by Ray Wren and Bill Nugent, they were able to get convictions and/or pleas by the three individuals involved. Mr. Brown went to trial and was convicted. Mr. Pannullo entered a plea on two counts of an information and Mr. Benjamin entered a plea to an indictment. Unfortunately, that does not put any money back into the fund. Mr. Brown was fined $7,500 and sent on his merry way. Mr. Pannullo, I don't know what he was fined. We cannot figure it out. Mr. Benjamin, who received 3 years, was ordered to make restitution of $325,000, which he doesn't have, obviously.

The problem that we have dealt with in this case was that early on, the PWBA became involved. As early as 1984, Mr. Benjamin was being chided by them for failure to file his Form 5500s. He was able to stonewall them for a period of 2 years. Mr. Benjamin was not sophisticated nor a particularly articulate individual, but he bought 2 years. In those 2 years, he stole approximately $600,000. So if, in fact, someone had acted early on, we probably could have cut the losses. But no one acted.

Letters went unanswered. Part of the problem was once we got involved—and when I say "we", I mean the new Board of Trustees, Mr. Zayas and myself, we began to cooperate with the PWBA on a regular basis. We have gone through four separate investigators. Every time we have to get a new investigator we have gone back to square one. The criminal trial of Mr. Brown was concluded on March 31, 1988. The guilty pleas of Pannullo and Benjamin were entered in March of 1988.

Mr. Brown did not appeal his conviction and as of today, there has been no action taken by the PWBA. The trustees of the funds at the expense of the funds have been forced to go this route alone. We are pursuing recovery actions against many of these lending institutions—"we" being the trustees of the funds and the professionals. We have recovered $909,000 to put the funds back in order.

Nothing has been recovered by the government. There was a criticism of the criminal handling of these cases. That did not occur in this situation. What is the problem? The problem is coordination. I understand that you cannot impinge upon a criminal investigation. I understand that the civil section could not move until the criminal case was concluded but the criminal cases were concluded a year-and-a-half ago.

I have not gotten any word that they are moving on the case. I had promises. We have had seven meetings with these people in the last 2½ years. We have cooperated with them 100 percent. We have given them deposition testimony that we have taken to help them in their case. Yet as we sit here, a week before Thanksgiving, 1989, the trustees are ready to move to recover the money but nobody else is.

As a result, what is the effect upon the funds? Financial burden. Neither Mr. Zayas nor myself can work for nothing. Potential statute of limitation problems because of the inaction of the DOL, increased losses to the funds because of interest we could not gain on these monies.

The recommendations; and we have been requested to make recommendations, there is apparently a staffing problem. There appears to be an underutilization of what they have. There appears to be a problem in retaining personnel because I should not have to reinvent the wheel every time somebody from that agency comes in. I have reinvented enough wheels to roll a car out of here. There should be controls over the workload, so I should not have to hear, "well, I have to work this weekend to finish this report and I have to work every weekend," and it has been 10 weekends since he allegedly finished the report, and the report is not done yet.

Establish reporting guidelines. Put more controls in. What you have to realize here is that there is a probability that the debacle that took place with Local 109 funds is not isolated.

While I am the first to admit that the majority of funds in this country, pension and welfare are run correctly, I work for a lot of funds a lot bigger than this fund and they cross their "t's" and dot their "i's" and that is fine. But if what occurred in Newark with unsophisticated people can occur, then what is going on in the rest of the country?

Another problem we have is that when people first got involved with the Form 5500, why it was not due, the Form 5500 they were writing about in December 1984 was due on 12/31/83. Mr. Benjamin, by a series of cryptic messages, was able to extend the reporting time until late 1985. The only reason they found things was after the criminal investigation began they subpoenaed everything and they found the letters that had come and the unanswered letters. As a result of what occurred, there are approximately 750 participants and beneficiaries in those funds who are at risk and approximately 125 pensioneers who are receiving checks who are at risk.

Fortunately—and I may have done it with mirrors—but from March of 1986 until today, none of these pensioneers ever missed a pension check. But these people were at risk. Right now they are not at risk. What bothers me is that there may be other people who are at risk. Thank you.

[The prepared statement of Mr. Friedman follows:]

STATEMENT OF PAUL A. FRIEDMAN

I am a partner in the law firm of DeMaria, Ellis & Hunt which is located in Newark, New Jersey where I specialize in the representation of companies and benefit funds in matters arising under the Employee Retirement Income Security Act of 1974 (ERISA), Title 29 U.S.C. Section 1001 et seq. At the outset I wish to thank the Committee for the opportunity to appear before you today and briefly outline the situation regarding the Local 109 Retirement Fund and the Local 109 Welfare Fund. The defalcations which occurred from those Funds can be seen in retrospect as the triumph of greed and corruption over ignorance and inexperience. Based upon current calculations and in light of the information which is presently available to the Trustees of the Funds, the magnitude of this tragedy may be seen in the fact that approximately 1.7 million dollars were looted from the Local 109 Retirement Fund and the Local 109 Welfare Fund. In addition, the Funds have been subject to numerous lawsuits exposing them to claims of third-parties in amounts approaching $200,000, resulting in a total loss to the Funds of lost assets and incurred liabilities of 1.9 million dollars.

A. Background of the Local 109 Retirement Fund and the Local Welfare Fund.

For many years Local 109 of the Hotel and Restaurant Employees International Union (HERE) represented employees of hotels, restaurants and bars that were located within the vicinity of Newark, New Jersey. The majority of its membership were bartenders, waitresses, waiters and kitchen help. As you might imagine in the years prior to 1980, this Union had become the spokesmen for workers in a declining industry and in a largely depressed area due to the decline of Newark and the closing of many of the businesses that had employed members of Local 109. Membership was small and the members of Local 109 were largely older people with very modest means and with no particular experience in financial matters. Prior to January 1981, employers that were signatories to collective bargaining agreements with Local 109 contributed to the Local 109 Retirement Fund and to the Local 109 Welfare Fund, both of which were employee benefit plans within the meaning of ERISA.

In January of 1981, as a result of the declining membership of the HERE locals within the vicinity of Newark, New Jersey, Local 109 merged with Local 131 of the Hotel and Restaurant Employees International Union to form Local 3 of the Hotel, Restaurant and Employees International Union. Subsequent to the merger, the majority of the members of Local 3 were employed by the Newark Board of Education. Pursuant to the collective bargaining agreements with Local 3, the Newark Board of Education provided its own medical insurance and made contributions to a state pension fund on behalf of its employees who were members of Local 3. After the merger, the former Local 109 members constituted a minority of the members of the Local 3. As a result of the collective bargaining agreements maintained with the former Local 109 contributing employers, contributions continued to be made to the Local 109 Retirement Fund and to the Local 109 Welfare Fund on behalf of the members of Local 3 who were formerly members of Local 109. At the time of the filing of the Form 5500 for the period ending 12/31/82, the Local 109 Retirement Fund and the Local Welfare Fund were shown to have combined assets of $1,542,000. The investment experience of both the Funds had been good and annual investment income coupled with contributions exceeded withdrawals. If the embezzlements had not occurred in the calendar years 1983, 1984, and 1985, the Funds would have realized a net increase in assets of $150,000. As a result, by the end of 1985 by conservative estimates the Funds would have had net assets of approximately $1.7 million dollars. However due to the embezzlements, as of February 1986, the Funds' combined assets were approximately $25,000.

B. The Fraudulent Schemes

In order to fully comprehend the extent of the tragedy it is necessary to understand the chronology of events subsequent to the formation of Local 3. On October 13, 1981, an individual by the name of James Carl Benjamin who had been an itinerant dishwasher employed by the Newark Board of Education was elected president of Local 3. Due to his position as president of Local 3, he also served as Chairmen/Administrator and as a Trustee of both the Local 109 Retirement Fund and the Local 109 Welfare Fund.

Between 1982 and February 1986, Benjamin was able to steal from the Local Retirement Fund and the Local Welfare Fund some $1.7 million dollars. Ironically most of the transfers of funds were not accomplished in a sophisticated manner. In most instances, Benjamin did not take large amounts. In fact, in one instance Benjamin drew a check directly to the Big Man's Shop on a Local 109 Retirement Fund account to purchase approximately $3000. in clothing for himself.

It appears that part of Benjamin's schemes was to induce the professionals servicing the Funds to resign. As a result for at least two years prior to February of 1986, the Funds functioned without an actuary, attorney or accountant. Once Benjamin was successful in removing those professionals, he and his cohorts were able to literally raid the Funds at will. Collateral in the form of Certificates of Deposit of the Local 109 Retirement Fund and the Local 109 Welfare Fund were pledged for loans to other entities, including Local 3, corporations owned or controlled by Benjamin and/or his cohorts and even to Benjamin's street people nominees. Several of the financial institutions that held Local 109 Benefit Funds must bear legal responsibility for the defalcations that occurred. Working in collusion with Benjamin were James Wellington Brown, a Vice President and Branch Manager of the Midlantic National Bank, a prominent New Jersey bank and, Thomas Pannullo a management trustee of both the Local 109 Retirement Fund and the Local 109 Welfare Fund and the proprietor of Thomm's, a Newark based restaurant. Pannullo who was encountering financial difficulties, utilized the proceeds of a Local 109 Retirement Fund certificate of deposit as collateral for a business upon which he owed taxes. Additionally, Benjamin pledged certificates of deposit of both the Funds as collatаral, to purchase personal items. In one instance he purchased a Lincoln and in another may have paid for his wedding reception utilizing Fund monies. Title to the Lincoln was later transferred to James Wellington Brown. Also prevalent among the schemes was the use by Benjamin of street people who were instructed to go to the Midlantic Bank and secure loans for thousands of dollars which were collaterialized by certificates of deposit of both the Local 109 Retirement Fund and the Local 109 Welfare Fund. The loans would be taken out by these individuals who would later deliver the loan proceeds to Benjamin. The loans would then be repaid to Midlantic either by withdrawals from Local 109 benefit accounts or by liquidations of certificates of deposits belonging to either the Local 109 Retirement Fund or the Local 109 Welfare Fund. In most instances, these were accomplished with the approval of James Wellington Brown.

While these schemes were being accomplished, the other trustees of the Funds, Union members with no financial experience, were deliberately kept in the dark by both Benjamin and Pannullo. As noted before, Benjamin had discharged the auditors for both of the Funds. As a result no filings were made with the Department of Labor in 1983, 1984 or 1985.

Other banks with which the Local 109 Retirement Fund and the Local 109 Welfare Fund maintained accounts also freely utilized the collateral from the Fund accounts, for other business purposes. In spite of the rule requiring the signatures of two trustees in several instances, these banks permitted removal of moneys from Fund accounts with only the signature of Benjamin and without proper authorization from the Funds. Ironically, in March of 1986, when the newly constituted Board of Trustees of the Local 109 Retirement Fund approached one of these banks about redeeming the last remaining certificate of deposit of the Fund which amounted to some $22,000., the officers of the bank demanded a resolution of the trustees authorizing the redemption of the certificate as well as requiring all the trustees to sign the resolution An inquiry concerning the differences in procedure went unanswered by the president and vice president of the bank.

Commencing in the Fall of 1984, the Department of Labor's Office of Pension and Welfare Benefit Programs began to correspond with Benjamin, at first advising that the Funds had failed to file the annual reports for the years 1983 and 1984. After the lapse of several months in which these requests went unanswered, the Pension and Welfare Benefit Programs sent an investigator to speak to Benjamin regarding the failure to file. Benjamin was able to forestall the investigation for several more months by simply stonewalling that agency. As a result, nothing was done until December of 1985, at which point 95 percent of the assets of the combined Funds had been depleted. At that time a criminal investigation was commenced which resulted in the execution of a search warrant upon the offices of Local 3 and the offices of the Funds in February of 1986. With the execution of that search warrant, Benjamin's schemes were finally discovered. However, in the intervening months between the initiation of the inquiry by the Department of Labor and the execution of the search warrant, Benjamin was able to destroy a myriad of records which would have shed further light upon the defalcations.

The criminal investigation which was spearheaded by Raymond Wren and Bill Nugent of the office of Labor Racketeering in the Inspector General's Office of the Department of Labor resulted in the entry of a guilty plea by Benjamin to four counts of a multi-count indictment in March of 1988. At or about the same time Pannullo entered a guilty plea to a two count Information charging him with conspiracy to embezzle from Pension and Welfare Funds and the actual embezzlement from the Pension and Welfare Funds.

In March of 1988, James Wellington Brown went to trial on a multi-count indictment and was ultimately convicted on five counts, charging him with conspiracy to embezzle from the Pension and Welfare Funds and embezzlement from the Pension and Welfare Funds. Ironically of the three conspirators, only one, Benjamin, received any jail time; three years. After sentencing, Benjamin was quoting as saying that his biggest regret in this entire affair was the loss of his right to vote. Pannullo was sentenced to probation as was James Wellington Brown despite his being found guilty on five counts. None of the three has made any restitution to the Funds.

Unfortunately, the victims of the embezzlement, the participants and beneficiaries of the Retirement Fund and the

Welfare Fund are still being punished. In addition, to the pillaging of the Funds, the actions of Brown, Benjamin and Pannullo exposed the Funds to several lawsuits which have resulted in the payment of at least $100,000. in settlement. Additionally participants and beneficiaries of the Welfare Fund went without medical coverage for several months which resulted in their medical claims not being covered. This circumstance is still being investigated by the present Board of Trustees who are attempting to rectify this injustice.

Ironically, despite the credible job done in the criminal investigation, the Office of Pension and Welfare Benefit Programs has yet to act. Despite being notified as early as 1986, that office has not yet commenced any remedial action to recover the stolen moneys. The present board of trustees of both the Funds have pledged their full cooperation to representatives of the Office of Pension and Welfare Benefit Programs on several occassions. This has resulted in at least seven meetings in which either Trustees of the Funds or professionals employed by the Funds have met with representatives of that office in an effort to resolve this matter. Pleas from the Funds have gone unanswered. The Trustees have been advised that the Department of Labor has not yet completed its review process or made a recommendation to sue. As a result, the Funds have been forced to seek recovery alone. The Board of Trustees and Fund professionals have been successful in recouping for the Funds some $990,000. However, the Funds' losses are still approximately 1 million dollars.

Unfortunately, the lesson that can be learned in reviewing this entire transaction is that crime can pay. Neither Pannullo nor Brown received a jail sentence and none of the three has made any attempt at restitution to the Funds. The only individuals who have suffered and have been punished are the participants and beneficiaries of these Funds.

Fortunately, between March of 1986, and the present time, the participants and beneficiaries of the Retirement Fund have received their monthly checks on a regular basis. However, the Trustees of the Funds in accordance with their fiduciary duties have been forced to expend Fund's monies to proceed against the banking institutions.

Mr. HUGHES. Thank you, Mr. Friedman.

Mr. Holland, welcome. We hope you can likewise summarize.

STATEMENT OF DONALD V. HOLLAND, ASSISTANT DIRECTOR OF THE ADMINISTRATIVE LAW SECTION, GEORGIA INSURANCE DEPARTMENT, ATLANTA, GEORGIA

Mr. HOLLAND. Mr. Chairman, I welcome the opportunity to appear today before this distinguished body to address the very serious problem encountered at the State level because of Multiple Employer Welfare Arrangements, MEWA, operating under the Employee Retirement Income Security Act of 1974, ERISA.

As background, I would like to discuss first how the MEWA problem, as I will call it for lack of a better name, came to the attention of the Georgia Insurance Department. In 1988, an investigation of a consumer complaint disclosed that an organization named OMNI Health Benefit Plan, OMNI, was selling major medical coverage to Georgia employees through its administrator, Harbor Medical Administrators of Georgia, Harbor. The persons operating OMNI claimed to be an ERISA welfare benefit plan.

Further, the investigation disclosed that OMNI's major medical insurance product was being sold through independent insurance agents not only in Georgia, but in Alabama, Virginia, North Carolina, South Carolina and Tennessee. In Georgia, the alleged coverage was sold to in excess of 190 Georgia employers with approximately 2,000 employee participants. OMNI's assets consisted entirely of employer/employee contributions partly in cash, but mainly as an account receivable. In other words, claims could not be paid until the employer/employee contributions were paid. The employer/employee contributions were used not only to pay claims, but administrative costs, including but not limited to, personal credit card charges for OMNI principals and automobile payments for a union official in Tennessee. At the time the Georgia Insurance Department "shut down" OMNI, its assets totaled $175,965.32 with outstanding claims in excess of $690,000. Harbor had collected premiums in excess of $2 million from its inception in November, 1987 until August, 1988.

Since OMNI, we have discovered eight other MEWAs operating in Georgia. Unlike OMNI, these MEWAs are operating from outside Georgia. This fact hampers investigation because financial records are maintained outside of Georgia. Therefore, we must rely on the information contained in Form 5500s filed with the Federal Internal Revenue Service, IRS, and the U.S. Department of Labor. Also, we would like to review the independent audited financial statements as required by IRS for MEWAs with 100 or more participants.

Unfortunately, three of the four Form 5500s we have reviewed on separate MEWAs were not completed or filed with an independent public accountant's opinion, when required.

I have these here with me today.

Information we have obtained on four MEWSs—OMNI, NBAT, Physicians and Summit—which operated in Georgia shows a total of 25,545 participants with annual contributions of approximately $21.2 million. These figures represent total for all the States in which the MEWA operates. We have been unable to separately identify Georgia participants. To allow organizations with such large numbers of participants to go virtually unrelated poses a very grave situation.

While Georgia residents insured under policies issued by licensed insurers are protected by various State laws which provide a safety net for various contingencies, no such laws cover MEWA participants.

The most important safety net, not available to MEWA participants, is our life guaranty fund which provides coverage to insured in the event of an insurer's insolvency. Other laws and regulations enacted or promulgated to protect Georgia residents which are not available to MEWA participants are conversion of benefits, continuation of coverage, and group and replacement regulations.

I also have letters from a couple of employers stating that fact, Mr. Chairman. I have not spoken to a single employer who realized that he or she had entered into a self-funded program with a resulting liability.

What is worse, most insurance agents have no idea that they are selling a self-funded program.

Our biggest problem is getting information, specially financial, on MEWA's operating from out of State. The financial records are out of State and not subject to an on-site examination. This prevents us from proceeding as rapidly as we would like in preventing harm to Georgia residents. We desperately need Federal assistance in this area.

In the past, Pension and Welfare personnel from the U.S. Department of Labor have provided us with very little assistance. However, as the result of a recent seminar held by the Law Enforcement Coordinating committee together with the U.S. Department of Labor's Inspector General's Office, some Federal-State coordination has begun.

Today, a great fraud is being perpetrated against the employees of those employers who usually employ 50 employees or less. Persons who are in fiduciary positions are enriching themselves to the detriment of the beneficiaries of the MEWA Trust.

This includes not only exorbitant administrative fees, but personal enrichment from commissions paid on group life as well as excess loss policies of insurance. Unless criminal sanctions are imposed, these indiscretions will continue.

At this time, we are working closely with the Inspector General's Office and providing what evidence we have obtained to hopefully bring about criminal prosecutions.

That is the end of my testimony, Mr. Chairman. I will hold myself up for questions.

[The prepared statement of Mr. Holland follows:]

TESTIMONY ON NOVEMBER 15, 1989 OF DONALD V. HOLLAND ASSISTANT DIRECTOR OF THE ADMINISTRATIVE LAW SECTION OF THE GEORGIA INSURANCE DEPARTMENT BEFORE THE U.S. HOUSE OF REPRESENTATIVES' SELECT COMMITTEE ON AGING'S SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

Mr. Chairman, I welcome the opportunity to appear today before this distinguished body to address the very serious problem encountered at the state level because of Multiple Employer Welfare Arrangements ("MEWA") operating under the Employee Retirement Income Security Act of 1974 ("ERISA").

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Further, the investigation disclosed that OMNI's major medical insurance product was being sold through independent insurance agents not only in Georgia, but in Alabama, Virginia, North Carolina, South Carolina and Tennessee. In Georgia, the alleged coverage was sold to in excess of 190 Georgia employers with approximately 2000 employee participants. OMNI's assets consisted entirely of employer/employee contributions partly in cash, but mainly as an account receivable. In other words, claims could not be paid until the employer/employee contributions were paid. The employer/employee contributions were used not only to pay claims, but administrative costs, including but not limited to, personal credit card charges for OMNI principals and automobile payments for a union official in Tennessee. At the time the Georgia Insurance Department "shut down" OMNI, its assets totaled $175,965.32 with outstanding claims in excess of $690,000.00 Harbor had collected premiums in excess of $2 million from its inception in November, 1987 until August, 1988.

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Unfortunately, three of the four Form 5500's we have reviewed on separate MEWA's were not completed or filed with an independent public accountant's opinion, when required.

One of the four Form 5500's showed the MEWA to be insolvent.

Summit Insurance Plan Trust ("Summit"), located in Breaux Bridge, LA, for example, left the balance sheet section in the Form 5500 for the year 1988 blank with the notation "N/A" in the right hand margin. In addition, an extension of time was filed. The reason for the extension was: "We are requesting an extension of time to file because of the lack of complete information available. We are missing just a few items, but expect to have these by the beginning of August. Therefore, we are requesting extensions until 8-31-89. This is the first time that we file Form 5500".

Summit's 1988 Form 5500 claims it has 2219 active participants with employer/employee contributions of $1,893.420.33. In addition, no independent public accountant's opinion was submitted with its Form 5500. To date, this is the only Form 5500 information we have received from Summit.

Physicians and Hospitals Benefit Trust of Long Beach, California failed in its 1988 Form 5500 filing to identify the number of employee participants and did not attach an independent public accountant's opinion. It had prepared the Form 5500 for 100 or more participants.

National Business Association Trust ("NBAT") filed a Form 5500 for 1988 with liabilities exceeding assets by $787,377.00. Although its 1988 Form 5500 claimed 16,623 members, NBAT failed to file an independent public accountant's opinion. The Georgia Commissioner of Insurance, Warren D. Evans, issued a cease and desist order against NBAT to prevent its further operation in Georgia.

Information we have obtained on four MEWA's (OMNI, NBAT, Physicians and Summit) which operated in Georgia shows a total of 25,545 participants with annual contributions of approximately $21.2 million. These figures represent totals for all the states in which the MEWA operates. We have been unable to separately identify Georgia participants. To allow organizations with such large numbers of participants to go virtually unregulated poses a very grave situation.

While Georgia residents insured under policies issued by licensed insurers are protected by various state laws which provide a safety net for various contingencies, no such laws cover MEWA participants.

The most important safety net, not available to MEWA participants, is our life guaranty fund which provides coverage to insureds in the event of an insurer's insolvency. Other laws and regulations enacted or promulgated to protect Georgia residents which are not available to MEWA participants are conversion of benefits, continuation of coverage, and group and replacement regulations.

What is most distressing is that employers seeking insurance through a MEWA do not realize they are in a self funded program. I have not spoken to a single employer who realized that he or she had entered into a self funded program with its resulting liability. What is worse, most insurance agents have no idea that they are selling a self funded program.

Our biggest problem is getting information, especially financial, on MEWA's operating from out of state. The financial records are out of state and not subject to an on site examination. This prevents us from proceeding as rapidly as we would like in preventing harm to Georgia residents. We desperately need federal assistance in this area.

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SUMMARY OF TESTIMONY ON NOVEMBER 15, 1989 OF DONALD V. HOLLAND ASSISTANT DIRECTOR OF THE ADMINISTRATIVE LAW SECTION OF THE GEORGIA INSURANCE DEPARTMENT BEFORE THE U.S. HOUSE OF REPRESENTATIVES' SELECT COMMITTEE ON AGING'S SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

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In 1988, an investigation of a consumer complaint disclosed that an organization named OMNI Health Benefit Plan ("OMNI") was selling major medical coverage to Georgia employers through its administrator, Harbor Medical Administrators of Georgia ("Harbor"). The persons operating OMNI claimed to be an ERISA welfare benefit plan.

OMNI's major medical insurance product was being sold through independent insurance agents not only in Georgia, but in Alabama, Virginia, North Carolina, South Carolina and Tennessee. OMNI's assets consisted entirely of employer/employee contributions partly in cash, but mainly as an account receivable. In other words, claims could not be paid until the employer/employee contributions were paid. All MEWA's we have subsequently investigated are operating on the same cash flow basis. The employer/employee contributions were used not only to pay claims, but administrative costs, including but not limited to, personal credit card charges for OMNI principals and automobile payments for a union official in Tennessee. At the time the Georgia Insurance Department "shut down" OMNI, its assets totaled $175,965.32 with outstanding claims in excess of $690,000.00 Harbor had collected premiums in excess of $2 million from its inception in November, 1987 until August, 1988.

Since OMNI, we have discovered eight other MEWA's operating in Georgia. Unlike OMNI, these MEWA's are operating from outside Georgia. We desperately need federal assistance in this area. We rely on information contained in Form 5500's filed with the Federal Internal Revenue Service ("IRS") and the U.S. Department of Labor.

Unfortunately, three of the four Form 5500's we have reviewed on separate MEWA's were not completed or filed with an independent public accountant's opinion, when required.

Information we have obtained on four MEWA's which operated in Georgia shows a total of 25,545 participants with annual contributions of approximately $21.2 million. These figures represent totals for all the states in which the MEWA operates.

While Georgia residents insured under policies issued by licensed insurers are protected by various state laws which provide a safety net for various contingencies, no such laws cover MEWA participants.

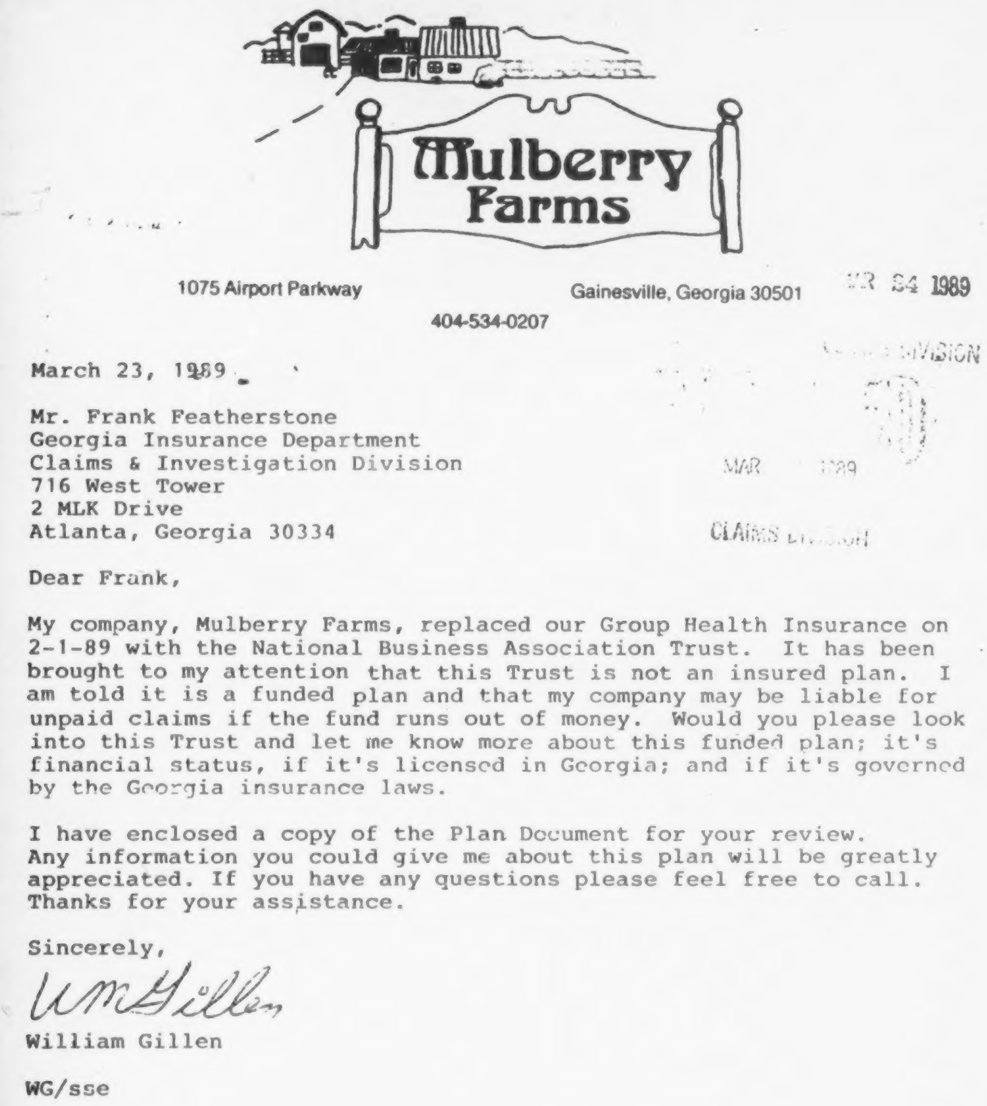
What is most distressing is that employers seeking insurance through a MEWA do not realize they are in a self funded program. I have not spoken to a single employer who realized that he or she had entered into a self funded program with its resulting liability. What is worse, most insurance agents have no idea that they are selling a self funded program.

Today, a great fraud is being perpetrated against the employees of those employers who usually employ fifty employees or less. Persons who are in fiduciary positions are enriching themselves to the detriment of the beneficiaries of the MEWA Trust. This includes not only exorbitant administrative fees, but personal enrichment from commissions paid on group life as well as excess loss policies of insurance. Unless criminal sanctions are imposed, these indiscretions will continue.

Mr. HUGHES. Thank you, Mr. Holland. Do you have some employer letters you would like to submit for the record?

Without objection, they will be so received.

[The supplemental material submitted by Mr. Holland follows:]



Mulberry Farms

1075 Airport Parkway Gainesville, Georgia 30501
404-534-0207

MAR 24 1989
DIVISION

MAR 1989
CLAIMS DIVISION

March 23, 1989

Mr. Frank Featherstone
Georgia Insurance Department
Claims & Investigation Division
716 West Tower
2 MLK Drive
Atlanta, Georgia 30334

Dear Frank,

My company, Mulberry Farms, replaced our Group Health Insurance on 2-1-89 with the National Business Association Trust. It has been brought to my attention that this Trust is not an insured plan. I am told it is a funded plan and that my company may be liable for unpaid claims if the fund runs out of money. Would you please look into this Trust and let me know more about this funded plan; it's financial status, if it's licensed in Georgia; and if it's governed by the Georgia insurance laws.

I have enclosed a copy of the Plan Document for your review. Any information you could give me about this plan will be greatly appreciated. If you have any questions please feel free to call. Thanks for your assistance.

Sincerely,

Wm Gillen

William Gillen

WG/sse

PAYLE$$
PACKAGE EXPRESS sm
Phone: (404) 761-6220
OF GA. INC.
2459 Roosevelt Hwy.
College Park, GA 30337

RECEIVED
OCT 23 1989
ENFORCEMENT DIVISION

October 19, 1989

Mr. Don Holland
Office of Commissioner
of Insurance
2 MLK Jr Drive, Floyd Bldg.
Suite 707, West Tower
Atlanta, Georgia 30334

RE: Health Insurance Benefits
National Benefit Marketing, Inc.
Dual Plus

Dear Mr. Holland,

I am writing this letter of complaint against the above referenced insurance company, in hopes that you may be able to prevent them from causing problems for other businesses in Atlanta. While trying to locate a health benefits plan for our office. I was approached by John Turney, an agent representing National Benefit Marketing, Inc..

Mr. Turney presented several different proposals. After careful consideration I chose Dual Plus. Some of my reasons for chosing this insurance company were 1) A Physicians and Hospital Guide. The guide listed many doctors in the Atlanta area which accepted Dual Plus. 2) The plan called for no deductible and a 90% - 10% co-payment plan if employees would visit these doctors when needed.

After six weeks we still had not received our insurance cards or manuals, etc. In the meantime one of our employees needed to see a doctor. She looked thru the book and called one of the listed physicians. The receptionist informed her they had never heard of Dual Plus. We began calling doctors from the list and were repeatedly informed they did not participate in the Dual Plus Insurance Program.

I called Mr. Turney for two days (to no avail) to let him know we were having problems. Finally his office manager returned my call, I was instructed to call yet another company which works with Dual Plus. When I called and explained the problems we were having, I was informed they were in the process of revising their list.
At this time there were no doctors available on the southside of town that would honor the insurance. There are very few doctors in the guide who have heard of Dual Plus or would accept the insurance.

Letter to Mr. Don Holland
October 19, 1989
Page Two

Upon calling your office for information on Dual Plus, I found out Dual Plus is a self-insured company not through a licensed carrier. Since I was never informed of this along with the other problems we have encountered, I feel like Mr. Turney has misrepresented this insurance.

Hopefully, by writing this letter to your office, and bringing this matter to your attention. You will be able to prevent Dual Plus from causing problems for others in similar situations.

Thanking you in advance.

Sincerely,

Debby R. Niblett

Debby R. Niblett

Mr. **Holland.** I also have three form 5500s of great interest.

Mr. **Hughes.** Without objection, they will be received.

[See Appendix 2, p. 209 for form 5500's submitted by Mr. Holland.]

Mr. **Hughes.** Thank you.

Mr. Capelli.

STATEMENT OF ANDREW J. CAPELLI, CHAIRMAN, EMPLOYEE BENEFIT PLANS COMMITTEE, AMERICAN INSTITUTE FOR CERTIFIED PUBLIC ACCOUNTANTS

Mr. **Capelli.** Thank you, Mr. Chairman. I am Andrew J. Capelli, Chairman of the AICPA's Employee Benefit Plans Committee. I am also a former member of the Department of Labor's Advisory Council on Employee Welfare and Pension Benefit Plans. With me today is Joseph F. Moraglio, Vice President, Federal Government Relations of the American Institute of Certified Public Accountants.

I appreciate your request to have our full statement placed on the record and I will summarize from that full statement now.

Mr. **Hughes.** We appreciate that.

Mr. **Capelli.** AICPA is fully supportive and has been since 1978 of the view expressed by the Department of Labor's Inspector General that all pension plan audits should be full scope and the so-called limited scope exemption in section 103 of the Act be eliminated.

Additionally, we are willing and have stated publicly here at Congress and also at the Department of Labor, our willingness to do compliance auditing on behalf of plan participants and the Department of Labor.

We have agreed to work with the Department in this regard and develop the procedures necessary to accomplish this. We have already discussed with the Department of Labor methods in use at other agencies which permits those agencies to be aware of findings of particular interest to those agencies with respect to its regulatory structure and scheme.

We are more than willing to work with the Department of labor to accomplish reporting and get to the Department of Labor on matters of concern. With respect to audits of plans of less than 100 participants, we certainly are in agreement that audits of entities, whether they be plans with less than 100 participants, multiple employer trusts, as we have just heard or any entity would be benefited by a financial statement audit, full scope without limitation.

We will work with the Congress to reevaluate the current provisions of the law to the extent that you believe there is appropriate cause to impose upon entities currently exempted from the audit provisions the audit burden associated with the engagement of an independent public accountant.

As to the specific comments of the Department of Labor Inspector General, let me quote in part from a statement issued by Mr. Charles Kaiser, Chairman, AICPA. He stated, "We strive to improve the quality of audits and are disturbed at any time there is a suggestion that the audit work was not of top quality.

"I have instituted the following steps to follow up on the I.G. report. One, directed the AICPA staff to conduct an analysis of the facts behind this study and report back to me within 90 days outlining the extent of any problems along with the suggested solutions. We are asking the Department of Labor for a full analysis and details on all the audits so we can evaluate their quality and see if there is a pattern requiring attention.

"We are also contacting all the firms involved and asking for details of their work. We continue to work with representatives of the Inspector General and the Pension, Welfare Benefits Administration to update the AICPA audit accounting guide which provides guidance to CPAs doing ERISA audits."

Mr. Chairman, I would suggest if it is of interest to the committee we would be happy to provide you with the complete analysis of the I.G. findings when that is completed.

Mr. HUGHES. That would be welcome, Mr. Capelli. Do you contemplate it will take up to 90 days to complete that?

Mr. CAPELLI. At least that long. We have to first access the information.

Mr. HUGHES. It would be very helpful to the committee if you could provide that. We appreciate the offer.

Mr. CAPELLI. That concludes my remarks.

[The prepared statement of Mr. Capelli follows:]

STATEMENT OF ANDREW J. CAPELLI

CHAIRMAN

EMPLOYEE BENEFIT PLANS COMMITTEE

OF THE

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

BEFORE THE

SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

OF THE

SELECT COMMITTEE ON AGING

UNITED STATES HOUSE OF REPRESENTATIVES

ON

ENFORCEMENT OF THE NATION'S PRIVATE PENSION PLAN SYSTEM

NOVEMBER 15, 1989

Mr. Chairman, members of the Subcommittee, I am Andrew J. Capelli, Chairman of the AICPA's Employee Benefit Plans Committee. I am also a former member of the Department of Labor's Advisory Council on Employee Welfare and Pension Benefit Plans. With me today is Joseph F. Moraglio, Vice President, Federal Government Relations of the American Institute of Certified Public Accountants.

The American Institute of Certified Public Accountants (AICPA) is the national professional association of certified public accountants (CPAs) representing more than 285,000 CPAs in public practice, industry, government, and education. Over the years, the AICPA has been a principal force in the development of professional standards, guidance, and educational programs designed to improve the quality of services provided by CPAs. Throughout its more than 100 years of service to the public and to its members, the AICPA has become widely recognized as the authoritative voice of the profession in the United States. We appreciate the opportunity to present our views today regarding certain Employee Retirement Income Security Act (ERISA) issues. We also stand ready to work with this Subcommittee and the Department of Labor (DOL) to address any issue of mutual concern and interest.

Introduction

The central focus of your proceedings today is the current oversight and enforcement of the nation's private pension plan system under ERISA. You have asked us to address several specific issues relative to the present role of independent auditors and improvements to ERISA enforcement. We will address those matters in this statement.

Present Role Performed by Independent Public Accountants

The primary purpose of ERISA is to protect the interests of participants and their beneficiaries. ERISA seeks to attain that objective by requiring disclosures to participants and beneficiaries, by establishing standards of conduct for plan fiduciaries, by requiring financial reporting to government agencies, and by providing appropriate remedies, sanctions, and access to the federal courts.

The report of most significance to the independent auditor is the annual report by the plan. Generally, plan administrators of plans with 100 or more participants at the beginning of the plan year must prepare and file an annual report (Form 5500) containing, with certain exceptions, financial statements, supporting schedules, footnotes required for a full and fair presentation, and other information including an independent auditor's report. As required by ERISA, the auditor's report is based upon an audit of the financial statements conducted in accordance with generally accepted auditing standards (GAAS).

When auditing the plan's financial statements in accordance with GAAS, the auditor's objective and responsibility is to express an opinion on whether the plan's financial statements are fairly presented in accordance with generally accepted accounting principles and are free from material misstatements, whether caused by fraud or error. In so doing, the auditor gives reasonable assurance to the users of those statements that the financial information, including total assets and liabilities reported by the entity, is credible.

Restrictions on Audits of Pension Plan Assets Held in Banks and Other Institutions

The limited-scope audit constraint on the utility of independent audits results wholly from the current statute and regulations and the practices of plan administrators. Section 103 of ERISA requires the administrator of an employee benefit plan to engage an independent accountant to conduct an audit of the financial statements of the plan in accordance with generally accepted auditing standards. However, Section 103(a)(3)(C) provides that the independent accountant is not required to express an opinion on statements of a common or collective trust or a separate trust maintained by a bank or similar institution or a separate account maintained by an insurance carrier if such statements are certified by such institutions as being accurate. Regulations issued by the DOL permits the plan administrator to exclude those assets from the scope of the independent audit. We understand that in about half of the required audits plan administrators have exercised this authority and restricted the auditor's audit of the assets held and transactions executed by such institutions. When this occurs, in virtually all cases, the auditor will conclude this is a significant limitation on the scope of his or her audit and will not express an opinion on the overall fairness of the financial statement presentation. This disclaimer of an opinion gives no assurance to plan participants on whether the financial statements are presented fairly in conformity with generally accepted accounting principles.

The AICPA is on record, beginning in 1978 and most recently in 1988, as stating that the scope of the audit should not be restricted in any way. Plan participants cannot be provided the full assurance contemplated by ERISA if the independent accountant's audit is restricted, as permitted by Section 103(a)(3)(C). If the Congress wishes to remove this constraint on the utility of required audits, it need only eliminate the authority to impose limitations on the scope of audit.

Ironically, over the years, several legislative attempts have been made to restrict the scope of independent audits even beyond that which may be imposed currently by the plan administrator. When scope limitations of this nature have been proposed, we have communicated our concern to Congress in written and oral statements.

Inspector General's Criticism That Independent Audits Fail to Disclose ERISA Violations to Plan Participants

The independent auditor's principle concern is to see that all GAAP disclosures are contained in the financial statements filed with the Form 5500 and not to ensure compliance by the plan administrator with ERISA requirements. Nevertheless, the independent auditor, as required by GAAS, must consider laws and regulations that have a direct and material effect on the determination of financial statement amounts. Additionally, if specific information comes to the auditor's attention that provides evidence concerning the existence of possible illegal acts that could have a material indirect effect on the financial statements, the auditor is required to apply audit procedures that are specifically directed to ascertaining whether an illegal act has occurred. Whether an act is, in fact, illegal is a determination that is normally beyond the auditor's professional competence. An auditor, in reporting on financial statements, presents himself or herself as one who is proficient in accounting and auditing. While the auditor's training, experience, and understanding of the client and ERISA and related DOL regulations may provide a basis for recognition that some acts coming to the auditor's attention may be illegal, the determination as to whether the act is, indeed, illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law. Because of the characteristics of illegal acts, an audit made in accordance with GAAS does not provide assurance that prohibited transactions, or other illegal acts, would be detected or that any contingent liability that may result will be disclosed. Nevertheless, in revising the AICPA audit guide for employee benefit plans, the AICPA Employee Benefit Plans Committee, together with the DOL Chief Accountant's Office, will be providing additional guidance on planning the audit to detect transactions prohibited by ERISA.

As to materiality, auditors design their tests and make judgments relative to conditions that are disclosed in the financial statements based on an assessment of materiality in relation to the financial statement taken as a whole. Audits are not directed at detecting all violations of laws and regulations. Any irregularity or illegal act that comes to the auditor's attention, other than those that are clearly inconsequential, is brought to the attention of the audit committee or others with similar authority and responsibility.

Disclosure of matters other than those that affect the auditor's opinion on the plan's financial statements to those outside the client organization is generally precluded by the auditor's ethical and legal obligation of client confidentiality. Any additional requirement for reporting information about matters of non-compliance directly to the DOL should be imposed by the DOL upon the plan administrators and not on the independent auditors.

Other Recommendations for Improving ERISA Safeguards

In addition to requiring full-scope audits, compliance audits could provide an additional assistance to ERISA enforcement. As we noted in our testimony before the Employment and Housing Subcommittee, the Congress and DOL must determine whether an increase in the scope of work performed is desirable and beneficial. If testing compliance with laws and regulations is determined to be cost beneficial by the Congress or the DOL, we will work with the DOL in developing necessary procedures that the auditor will apply in testing such compliance and in rendering the appropriate report in accordance with the AICPA's attestation standards. Any laws and regulations on which auditors would test and report must relate to financial matters within the competence of auditors to evaluate and there must be reasonable agreed-upon criteria to measure compliance.

Conclusion

Mr. Chairman, with respect to the IG's review of the selected ERISA audits, we do not know whether the alleged deficiencies were minor or significant. We do not know whether we are talking about a parking ticket or a case of hit-and-run. Such deficiencies do not necessarily place any of the plan assets or participants at risk or suggest that the Department of Labor is not doing an effective job enforcing the law because it did not identify the missing information.

Having said that, Mr. Chairman, I want to assure you that the AICPA takes seriously any allegation of substandard performance by its members and will work with the Congress and the Department of Labor to address this matter.

That concludes our remarks. We will now attempt to answer any questions you may have.

Mr. **Hughes**. Thank you.
Mr. Walker.

STATEMENT OF THOMAS C. WALKER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ASSOCIATED BENEFITS CORPORATION

Mr. **Walker**. Thank you, Mr. Chairman. I also will summarize and attempt to be brief.

The Inspector General's report has created a great deal of conversation and a great deal of concern, much of it on behalf of people who do not have access to the information that would tell them whether they are, in fact, in jeopardy.

In the Des Moines Register of yesterday, the Inspector General was quoted again with the comparison of the S&L crisis. This generated a number of phone calls to our office yesterday from plan participants questioning whether they were one of the 1-in-4 who were going to lose their pension privileges. He raises some very serious issues and some very real problems.

The 64 percent of the audits he quotes in his study as not meeting the ERISA disclosure requirements for the independent audit is a very real problem. One of the other things his report discloses is that ERISA section 104(a)(4) and (5) and the remedies included in them for these types of omissions or errors have never been tried.

These remedies are applicable over the plan administrator and what he is suggesting is that they are not the appropriate party to apply these audit standards to. The reason that he starts saying the plan administrator is not the correct party to look to, and I quote from his report, "They may not have the expertise to evaluate IPA reports."

I would suggest that professional plan administrators do, in fact, have the expertise to evaluate IPA reports. Those who don't, if the PWPA were to exercise one of the three enforcement provisions that are already in the code, would either very quickly get the expertise or make the decision that there was perhaps another line of work that would be more appropriate.

I think it is unreasonable to suggest that we need to add regulations to those that already exist when those that exist have never been tried.

The issue that was raised by the Inspector General is obviously a legitimate one. The real issue is the lack of action by the PWBA, not one of lax controls by administrators and not one of incompetent IPAs. The issue of plan assets excluded from audits raises a very interesting question. We happen to use section 2520.103-8, which allows us under ERISA to have a qualified audit. I looked at our particular bank. I would ask, Mr. Chairman, that you specifically review the 4 pages that are attached to my written testimony which came from our master trustee bank stipulating the ERISA audit procedures that they go through.

I talked with our auditors and our master trustee bank and let me explain what they think a full-blown enforcement of what appears to be the Inspector General's recommendation would cause.

Our auditor estimates that for them to go down and audit assets, as it were, at our master trustee bank it would elevate our audit costs by something in the range of six to seven times the amount we currently spend. Our bank, on the other hand, estimates that if they were to house auditors for each of the plans that they are master trustees for and if each of those audits took the 4 weeks our auditor estimated ours would take, they would be in a position of having to add something in the neighborhood of seven floors to their bank. I suggest that is not something they would do without additional cost to the plans that created that problem for them.

The outline I have attached to my written testimony lays out what I believe to be a very complete ERISA compliance audit procedure that our bank follows. We use the qualified audit because it is allowed by ERISA. I would have no problem in moving to an unqualified audit relying upon the audit information that the auditors of our trustee bank would then supply to us. I think that is a perfectly logical end result.

The I.G. says that his recommended "audit coverage of ERISA assets in banks and similar institutions would not be duplicative and would provide additional protection of plan assets through increased scrutiny that does not now exist." I would suggest, Mr. Chairman, that there is really no way to deny the accuracy of what he said. I would also suggest that building another wall 100 yards into the ocean around San Quentin would have provided an additional security, but would the end result merit the cost?

The report also mentioned the receipt of audits. They are generally up to 2 years old before they receive them through the transfer system of the Government. The volume causes them to store them away without review.

I think the I.G. has discovered a real problem here. I think a logical solution to this, and I do not mean to be facetious, would be a lottery-type drawing by employer identification number. If the PWBA were to determine at the beginning of any given year the number of audits that they wanted to review first hand, get their lottery machine to spit out EINs in the appropriate number and then ask those employers with the EINs to report directly to the PWBA with their audits, I think they could control their work flow and that would guarantee a random selection.

Mr. Hughes. I hate to interrupt you. There is a vote in progress and I have only about 4 minutes to make it to the floor.

I would like to recess now and then come back in a few minutes and you can complete your testimony and we will go to questions.

[A short recess was taken.]

Mr. Hughes. The subcommittee will come to order.

I think you were saying, Mr. Walker, that you would recommend a random lottery system to deal with the problem.

Mr. Walker. Yes, Mr. Chairman. It appeared from the testimony we heard this morning that one of the problems that the PWBA has in concert with many of the other government agencies are the problems created by budget constraints and the fact that they don't have a tremendous number of people.

I think any reasonable person would recognize that 920,000 reports and audits being reviewed annually with a staff of 270 is a logistical impossibility. I think that the current system, which has all of us as plan administrators filing the various reports, which are then stored because of an inability to do the followup work on them, really accomplishes nothing either.

The only reason that I use the lottery-type drawing of EINs is because we all recognize that lotteries are in fact random and if random selection is what they are after, that would certainly work. The I.G. also strongly recommended that IPAs be deputized, for lack of a better word, by the government to report any irregularities they find in the audits that they do of the plans directly to the PWBA. I have both intellectual and emotional difficulties with that particular approach. These are the reasons: there is now annual congressional legislative activity that impacts the benefits arena.

The annual legislative activity is followed some time within the next 10 years with the regulations pertinent to that legislation. The 10-year example I use is particularly relevant when we consider 401(k), which was legislated in 1978 and we got the final regulations in 1988. The time lag between legislation and regulation is a problem. What it does for us as plan administrators, is put us in a position of having to use "good faith" judgment between the effective date of the legislation and the regulations. I have a problem with the potential conflict that arises when an administrator's good faith judgment, which does not necessarily concur with an auditor's good faith judgment, neither being right or wrong, just different, but the IPA has to report to the PWBA about the discrepancy.

I also have a concern with the difficulty the PWBA has currently in looking at the records. I seriously doubt there is any plan in the country, Mr. Chairman, that is not in violation of something. It is just simply impossible to be in complete compliance today with the tremendous amount of legislative and regulative activity that we have had in the last few years. That doesn't mean they are not trying. I would strongly support IPA's reporting directly to the PWBA any concerns that they discovered in an audit that are not corrected within a reasonable period of time. I would suggest a reasonable period of time would be the 1 year between one audit to the next. I would also suggest that the statement of auditing standards numbers 53 and 54 address these issues and give the IPAs the ability to report any discrepancies that they find. I would suggest that those auditing standards be allowed to stand as is.

In summary, let me say that I am a believer in the philosophy that if it is too hot, get out of the kitchen. I also believe in the fact that stoking the stove until the house burns down does not accomplish anything of lasting value. I believe the I.G. found a problem with the system. I believe the problem should be dealt with. I believe the tools for fixing it already exist and I believe the problem can be cured without any additional legislation. I also believe the size of the problem has been somewhat overstated, particularly with the S&L comparison.

I would suggest that it is not necessary to give everyone a prescription because a few people get sick. I think the necessary pieces of the puzzle are in place. I support meaningful audit and enforcement. If, after the current tools have in fact been tried, they are found to be lacking in some areas, I would then support well thought-out new remedies to replace those that are proven not to work. Thank you, Mr. Chairman.

[The prepared statement of Mr. Walker follows:]

STATEMENT OF THOMAS C. WALKER, CEBS, CLU, ChFC IN CONNECTION WITH THE HEARINGS OF THE HOUSE SELECT COMMITTEE ON AGING'S SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT CONCERNING ENFORCEMENT OF THE NATION'S PRIVATE PENSION SYSTEM'S ERISA AUDIT PROCESS NOVEMBER 15, 1989.

ACRONYMS

AICPA - American Institute of Certified Public Accountants

DOL - Department of Labor

DTC - Depository Trust Company

EIN - Employee Identification Number

ERISA - Employee Retirement Income Security Act of 1974

FRB - Federal Reserve Banks

IG - Inspector General

IPA(s) - Independent Public Accountants

IRC - Internal Revenue Code

OCC - Office of the Comptroller of the Currency

PWBA - Pension and Welfare Benefits Administration

SAS - Statement of Auditing Standard

S&L - Savings and Loans

Summary of the principal points in the statement of Thomas C. Walker in connection with the hearings of the House Select Committee on Aging's Subcommittee on Retirement Income and Employment concerning the enforcement of the nation's private pension system's ERISA audit process November 15, 1989.

1. The IG of DOL's semi-annual report in June 1989 characterized pension plans as the next S&L type bailout Congress would face.
2. Questions about the appropriateness of that conclusion.
3. Suggests that ERISA already provides cures for the perceived problems and states the cures.
4. Questions PWBA's lack of enforcement actions.
5. Suggests since enforcement of current law never tried, new law should be delayed until current law tested.
6. Addresses issue of timely receipt and unreviewed storage of audit reports.
7. Suggests solutions to issues in No. 6.
8. Questions effectiveness of requiring IPA's to report directly to PWBA.
9. Suggests SAS #53 and #54, with slight modification, could be useful in meeting IG's concerns.
10. Suggests administrators are, by and large, not crooks and should not be treated like they were.
11. Summary.

As an introduction, I am the President and CEO of Associated Benefits Corporation, an Iowa Not-for-Profit Corporation. We are the sponsoring employer for over 300 employee benefit plans using regional prototype pension plans and welfare benefit trusts exempt under Section 501(a) of the Internal Revenue Code (IRC). We serve 156 agricultural cooperatives who provide over 6,000 plan participants with pension and welfare benefits. Our employers range in size, as measured by the number of employees, from 1 to over 700. We have only one large employer (more than 500 employees). We have three employers with over 100 employees (the largest of the three has 126). These four largest cooperatives have a total of 1,059 employees. The balance, approximately 4950, divided by the remaining 152 employers, makes the average slightly more than 32 employees per employer. The plan assets for all the plans we sponsor are approximately $110,000,000.00

Let me now address the subject of these hearings.

A study was done by the Inspector General (IG) of the Labor Department, and incorporated in the semi-annual report submitted by J. Brian Hyland in June of 1989. This report warned that "unless steps are taken now, today's (savings and loan) bailout may become tomorrow's ERISA nightmare." I have read the report and studied the study and based on what is contained therein, I find that conclusion seems to be based on a glaring fault with the system that literally jumps from the pages. That fault is that in the study of 279 plans, they found that Independent Public Accountants (IPA(s)) did not properly meet the Employee Retirement Income Security Act of 1974 (ERISA) disclosure requirements in 179 (64%) of the cases. That is deplorable and cannot be tolerated.

However, ERISA Section 104(a)(4) and (5) provides remedies for deficient IPA reports. The Pension and Welfare Benefits Administration (PWBA) can (1) reject incomplete reports and require plan administrators to file a satisfactory report within 45 days, or (2) retain an IPA to perform and audit and charge the plan for the audit costs, and/or (3) bring a civil action against the plan for whatever relief is appropriate. I found the most distressing problem in the entire study here. The report spent a great deal of space making a case for legislating authority for the PWBA directly over IPA's. Current law gives the PWBA (through ERISA Section 104(a)(4) and (5)) authority only over the administrator. The problem...the PWBA has NEVER MONITORED COMPLIANCE and they have NEVER TAKEN ANY ENFORCEMENT ACTION against a plan for noncompliance in financial reporting.

Since the PWBA can only take action against the administrator, and since the PWBA expressed the feeling that "they (administrators) may not have the expertise to evaluate IPA reports", enforcement action is deemed useless. I rather imagine it would only take one exercise of any of the three remedies mentioned above before the vast majority of administrators would either have the expertise necessary, or the sense to find some other way to earn a living.

I would suggest that neither the IG nor anyone else can prove the current enforcement provisions of ERISA are inadequate since it appears they have never been used. Is it unreasonable for someone like me, one of the regulated, to ask our regulators to use the tools they already have in their possession to fix a problem before asking Congress to declare the problem unfixable with the tools at hand? I think not. I would think it reasonable, nay prudent, to wait for the PWBA to try out powers they have, and then, if they can prove some of these powers do not provide the desired results after 3 years of use (for example), ask for those powers that are needed to supplement the present tools they discover do work.

The issue of plan assets held by, in our case, a trustee bank, being excluded from the audit is an interesting one. I have attached, as "Attachment Number 1", a copy of the opinion letter that accompanied our audit this year. Our auditor, as permitted by Section 2520.103-8 of the DOL's Rules and Regulations for Reporting and Disclosure under ERISA, did not go to our trustee bank. I asked our auditor for an approximation of the cost of the man hours and other related expenses that would be required for them to go to our trustee (located 200 miles from our offices) and do an audit sufficient to allow them to give us a qualified opinion. The estimate was for 2 people, spending a minimum of 4 weeks with all the attendant expenses for motels, meals and weekend returns home, and would have multiplied our current audit cost by approximately 7 times.

If the Funds using our master trustee facilities would all send their auditors to the bank each year, the bank estimates that they would need to add seven floors to their building to provide space to hold them. I can't imagine they would do this without a significant adjustment to their fee schedule.

The IG's report recognized that this is a logistical problem but still ends up recommending that "audit coverage of ERISA assets in banks and similar institutions would not be duplicative (of other bank audits) and would provide additional protection of plan assets, through increased scrutiny, that does not now exist". There is no way to deny the accuracy of that quote.

Building an additional wall around San Quentin would have "provided additional protection" there as well, but would the additional protection have meant anything?

The IG's report did not mention the many safeguards that plans already have in place to protect the plan against the risk of abuse and mismanagement by the trustee. Most plans have the consulting services of an actuarial firm that prepares an annual actuarial valuation. Most plans have the consulting services of a performance measurement firm that reviews fund performance against the Plan's stated goals and against other trustees and/or money managers. Most plans retain legal counsel that review all plan activities with an eye towards fiduciary compliance. Most plans have an administrator who cares. To find a situation where abuse and mismanagement still occurs, even with all these people involved, is certainly not impossible. It is also not common.

If, however, the statement made in the report that "plan assets and transactions in trust departments are not audited annually or even frequently" can be proven, I share the IG's concern. I have not, however, found a Master Trustee facility that does not subject itself to an inside audit at least annually and an outside audit at least every 3 years. The burden of the fiduciary responsibility trustee banks carry is recognized by them, and my experience is that they do not regard that responsibility lightly.

To Support this statement, I have attached a letter from the Senior Vice President and Manager of Audit Services from our Trustee Bank as attachment No. 2. You will note that they have "six auditors wholly committed to audits of the Trust Department, including the Employee Benefits Division".

The attachment goes on to list the procedures by specific audit areas, which regulations apply to each, and what ERISA coverage is specifically covered (ie: party in interest, prudent man, exclusive benefit, etc.). "The Trust audit activities are generally of two types, annual and continuous." The Audit Department reports directly to the president of the bank, and to the audit committee of the board of directors.

You will also note that a major firm performs an IPA's third-party review as well, and that the Office of the Comptroller of the Currency (OCC) is, in fact, a presence with everything from full scope audits to single issue OCC examiner/department manager meetings.

The letter also raises the question of whether a trustee bank such as our could even specifically identify each individual plan's assets for an IPA. "Many securities are held in a securities depository such as the Depository Trust Company (DTC) or in book entry form at the Federal Reserve Banks (FRB)".

The "Schedule of Limited Scope Audit Assets by Regulated Industry" table that is contained in the IG's report had a total of $4,190,704,612.00 that used limited scope audits. These dollars were held by 128 plans. The average plan, then, contains $32,739,880.00 in assets. This means that the employers sponsoring those plans were either relatively small, or the plan was relatively new. If the employers were small, multiplying their audit expense by 7 or more times will certainly not encourage plan continuation, nor will it encourage many employers to start new plans.

The plans are also not identified as being defined contribution or defined benefit plans. Investment control and management processes are different for each and knowing what kinds of plans are involved is important.

The report ends up recommending that limited scope audits be eliminated and that the PWBA be granted authority to require full scope audits of plan assets and transactions. The American Institute of Certified Public Accountants (AICPA) has stated that if bank trust IPA's do sufficient work, plan IPA's could place reliance on their work and eliminate their disclaimers of opinion. It appears to me the solution is already in place and no additional legislation is required.

The report also discusses the problem of timely receipt of audit reports by the PWBA and what the PWBA's Division of Reports does with them when they are received. The concern expressed is that audit reports are up to 2 years old before the PWBA receives them and that they get stored away by the Division of Reports without review.

The first part of this problem is easy. If it takes 2 years, and the government's internal inter-agency document transfer system cannot be improved, add the PWBA as an automatic direct recipient of all audits....but not if they are going to file them without looking at them. If the PWBA does not look at them, that is a PWBA problem that neither Congress nor plan administrators can cure.

If the IG's expressed concern that the volume of reports is too large for the PWBA to obtain reports directly is found to be valid, and I rather imagine that would be the finding, legislating IPA's as policemen is not a good solution. Perhaps a lottery-type drawing of Employer Identification Numbers (EIN's) for the number of audit reports that the PWBA could review that year would work. It would certainly guarantee random selection for those plans that would then be required to submit a copy of the audit report directly to the PWBA.

The suggestion that IPA's be required to report any irregularities directly to PWBA is fraught with both emotional and intellectual difficulties. With annual legislative activity impacting employee benefits now a certainty, and with the complexity this creates for administrators who must struggle with each new piece of legislation for as long as 10 years before final regulations are issued (case in point is 401(k) regs which were finalized in 1988 for the legislation passed in 1978), requiring IPA's to report every infraction and exposing administrators to criminal proceedings will soon eliminate professional administrators. We (professional administrators) know, all too well, that on any given day something could probably be found that could be interpreted as an infraction of the rules. I have absolutely no quarrel with correcting any and every infraction as they are realized. I have a very real quarrel with having my professional life in jeopardy because I make a good faith judgment on an issue that does not match up with an auditor's judgment.

Statement of Auditing Standard (SAS) #53 requiring an auditor to report to an Audit Committee, Board of Trustees, or other independent party makes sense and I support this as well as SAS #54 which prescribes the procedures to be followed when an illegal act is detected during an audit. I would not be opposed to reporting any infractions that are not corrected within a reasonable time directly to the DOL. Please note, I said UNCORRECTED infractions. Subjecting administrators to civil or criminal proceedings for "first occurrence" infractions, as requiring IPA's to report directly to the PWBA would surely do, would likely cause those of us who care the most about protecting our plan participants to seek other employment. Because professionals care, they also understand that their world is so complex that it is impossible to be perfect. Because professionals are competent, they can also find jobs that do not expose them to risks that are beyond their control. For these reasons (we care and we are competent), we have continued to accept the evermore complex challenges of our jobs, but at some point each of us will say "enough already."

Let me say that I'm a believer in the philosophy of "if it's too hot, get out of the kitchen." I'm also a realist and would suggest that stoking the stove until the house burns down doesn't accomplish anything of lasting value.

In summary, it is evident that the remedies available under ERISA to cure the problems perceived in the IG's study have not been tried. They should be before the law is changed.

As an outsider looking in, it appears that there has been a rush by Congress to pass laws, then think about the problem. Fire, ready, aim if you will. It seems there has been a tendency to change employee benefit laws then let others try to figure out how, or even IF, employers can comply. As one of the "others" who tries conscientiously to comply, I'd like to suggest a different approach. First, please be sure there is a problem before you take action. If the problem is real, then look at the options for solution that are available in terms of what each option will (1) accomplish and (2) cost. Then, make a conscious decision that the accomplishment is worth the cost...before you pass the law.

I believe the IG found evidence of a problem with the system. I believe the problem should be dealt with. I believe that tools for fixing the problem already exist. I believe they will work. I believe the problem can be cured with no additional legislation.

I also believe the size of the problem was dramatically overstated with the S&L comparison. Please, don't give us all an unneeded prescription because a few of us get sick. I support meaningful audit and enforcement. The necessary pieces to the puzzle of accomplishment are already in place, and I support using them. If, after they are used, problems that existing remedies can't cure are found, I will support well thought-out new remedies.

Respectfully submitted,

Thomas C. Walker

Thomas C. Walker, President
Associated Benefits Corporation
2929 Westown Parkway, Suite 220
West Des Moines, IA 50265

KPMG Peat Marwick

Certified Public Accountants

Peat Marwick Main & Co.
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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Associated Benefits Corporation
The Contributory and Noncontributory
Retirement Plans for Cooperatives:

We were engaged to audit the financial statements and schedules of The Contributory and Noncontributory Retirement Plans for Cooperatives as of March 31, 1989 and 1988 and for the years then ended, as listed in the accompanying table of contents. These financial statements and schedules are the responsibility of the Plan's management.

As permitted by Section 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the Plans' administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information referred to in note 3, which was certified by the United Missouri Bank of Kansas City, N.A., the trustee of the Plans, except for comparing the information with the related information included in the 1989 and 1988 financial statements and supplemental schedules. We have been informed by the Plans' administrator that the trustee holds the Plans' investment assets and executes investment transactions. The Plans' administrator has obtained a certification from the trustee as of and for the years ended March 31, 1989 and 1988 that the information provided to the Plans' administrator by the trustee is complete and accurate.

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and schedules taken as a whole. The form and content of the information included in the financial statements and schedules, other than that derived from the information certified by the trustee, have been audited by us in accordance with generally accepted auditing standards and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

Peat Marwick Main & Co.

June 1, 1989

Attachment No. 2 pg. 1

UNITED MISSOURI
BANCSHARES, INC.

November 10, 1989

Mr. Tom Walker
Associated Benefits Corporation
2929 Westtown Parkway, Suite 220
West Des Moines, Iowa 50265

Dear Mr. Walker:

Yesterday we spoke about the audit procedures that are utilized by the Internal Audit Department of United Missouri Bancshares to evaluate the internal controls of United Missouri Bank of Kansas City's Employee Benefits Department. UMB has six trust auditors who are wholly committed to audits of the Trust Department, including the Employee Benefit Division.

The Trust Audit activities are generally of two types, annual and continuous.

Annual Audit Procedures

Audit Areas	ERISA Coverage	Regulation
Overdrafts/ Uninvested Funds	Prudent (exclusive benefit rule)	ERISA, IRC, DOL & PBGC
Trust Account Statements	Parties in Interest	ERISA §103
	3% Rule (securities and brokers)	ERISA §103
	Certified statements	ERISA §103
Securities Trading	Parties in Interest	ERISA §406
Real Estate	Prudent (exclusive benefit rule)	ERISA §404
	Participant prommisory notes	ERISA & IRC
	Specific fidelity bonding	ERISA §412
Conflicts of Interest	Parties in Interest	ERISA §406 & 408
	Prudent (exclusive benefit rule)	ERISA §404
	Co-fiduciary breach of trust	ERISA §405
	10% rule (employer securities and UMBI stock)	ERISA §407
Liabilities	Parties in Interest	ERISA §406
	Prudent (exclusive benefit rule)	ERISA §404 & IRC §72
Income/ Disbursements	Expenses (prudent)	ERISA §404
	Participant distributions	ERISA, IRC & DOL

Attchment No. 2 pg.2

Mr. Tom Walker
Associated Benefits Corporation
Page 2
November 10, 1988

Audit Areas	ERISA Coverage	Regulation
Vault Counts	Asset verification	ERISA §402
	Prudent (exclusive benefit rule)	ERISA §404
	Parties in Interest	ERISA §406
Out-of-Bank	Asset verification	ERISA §402
	Prudent (exclusive benefit rule)	ERISA §404
	Parties in Interest	ERISA §406
Income (Trust Accounts)	Income verification	ERISA §404
	Prudent (exclusive benefit rule)	ERISA §404
Trust Fees	Fee verification	ERISA §408

Continuous Audit Procedures

Throughout the year, the Audit Department randomly selects accounts, including the employee benefit accounts, for administrative audit. An administrative audit generally consists of a review of the account's governing instrument(s), activity in the account for at least a 12-month period to determine that the transactions are executed in accordance with the governing instruments and laws relative to the administration of the account, including ERISA, where applicable, and that income/fees/distributions/contributions are properly recorded.

Through subscriptions to industry publications and legal update services, as well as working closely with the Employee Benefits Division, we are able to stay abreast of regulatory and procedural changes in the Employee Benefits area, and we modify our audit procedures accordingly.

We also review required management approvals for new and closed accounts, as well as approvals for those investments for accounts where the bank has investment responsibility.

Although the report we received from you stated, in part, that the guidelines (for internal auditors) they reviewed did not indicate any consideration for ERISA, I believe you can see that our audit coverage does include ERISA regulations.

Obviously the independence of any auditor is essential for correction of problems identified. At UMB the Audit Department reports to the president of UMB and to the audit committee of its board of directors. We also report audit findings relative to the Trust Department of UMB of Kansas City to the Trust Audit Committee of the bank's board.

External Audit Coverage

In addition to the internal audit coverage of the Trust Department, UMB of Kansas City has engaged the holding company's independent public accounts, Touche Ross and Co., to make a third-party review of the internal controls within the Trust Department, specifically for the use of its clients and their respective audit firms. When Touche Ross conducts this review, one of the audit procedures includes the review and analysis of all the holding company's Trust Audit work.

Attachment No. 2 pg. 3

Mr. Tom Walker
Associated Benefits Corporation
Page 3
November 10, 1989

Many of the benefit plans have elected to participate in the pooled funds maintained by the Trust Department. These funds are individually audited annually by an independent public accountant.

UMB of Kansas City has made a strong commitment to both its internal and external audit program for the Trust Department to help assure accurate transaction processing and reporting.

Tom, I'd like to make the following general comments with respect to the portion of the Department of Labor study you sent us as it relates to direct audit verification of plan assets. The study implies that a limited scope audit was initially allowed because of the desire to exempt institutions from duplicate audits, and that the current reduction in the examination frequency does not provide adequate protection for the plan participants.

Since UMB of Kansas City is a national bank, I'm most familiar with the examination practices of the OCC. It's true that the OCC's Trust Department examination frequency is no longer annual; this is related to a new risk evaluation method the OCC has adopted whereby the stronger banks are examined less frequently and more examination emphasis is directed toward the banks with greater risk. The OCC does examine UMB of Kansas City annually; every department, however, is not included in the exam. In addition to the examinations, the OCC has an examiner meet with various department managers throughout the year to help evaluate the operation of the bank. If there were problems or significant personnel changes, in particular areas, they could be examined at any time depending on the OCC's perceived need for a special exam.

Even if the law for employee benefit plans were changed to require that the assets of every plan be verified by an independent accountant each year, I question the ability of the trust companies to specifically identify each plan's assets. Many assets are held in a securities depository such as DTC or in book-entry form at the Federal Reserve Banks. As part of the bank's control process, the Trust Department reconciles securities held in DTC weekly and securities held in book-entry form monthly, but these reconciliations consider security positions for all accounts rather than holdings on an individual-account basis.

In my opinion, the ultimate safety of plan participants will not be achieved with additional audit or regulatory examination requirements, but from the division of responsibility inherent in a system whereby the plan administrator monitors the activities of the plan trustee and vice-versa. I'm sure this division of duties was a major consideration in the original decision to allow limited scope audits and the division of duties concept is equally strong today as a protection for the plan participants at a reasonable cost.

Attachment No. 2 pg. 4

Mr. Tom Walker
Associated Benefits Corporation
Page 4
November 10, 1989

I hope that I have been able to help in sharing our audit philosophy with you. If I can answer any questions about this, please call me at (816) 556-7575.

Sincerely,

Thomas W. Switzer, CBA
Senior Vice President and
Manager of Audit Services

dls

cc Bob Reiter

Mr. Hughes. Thank you very much, Mr. Walker.

Let me just start with your testimony, if I might. I thank you for it. You have made a very significant contribution here today and we appreciate it, as have all the other witnesses today.

You suggest that no new legislation is required. Yet, we do not presently cover public retirement systems. That would require new legislation, would it not, if, in fact, it is felt we need to deal with that particular problem also?

Mr. Walker. Mr. Chairman, I am probably unqualified to address the issue of public plans. My reference to no additional legislation being required was in the area of additional enforcement kinds of legislation. I am not qualified to address the public plan issue.

Mr. Hughes. I take it you do agree, however, that the limited scope provisions where we exclude those plans or portions of those plans that are basically deposited, let's say, with a regulated institution is something we need to take a look at.

Mr. Walker. I believe the AICPA has in place a provision that would allow plans such as ours to rely on the IPGA audit of our trustee facility and move then from the qualified to the unqualified audit. I support that. I would not support our auditors having a presence in our trustee bank because of the obvious logistical problems that occur.

Mr. Hughes. I understand. How would you propose that we deal with the potential risk that is inherent with all those private pension plans that are presently exempt and those with fewer than 100 employees, for instance, which represent the vast majority of plans out there, probably the plans that would not have the professional expertise in many instances that you take to your particular entity.

Mr. Walker. Well, if you will recall, Mr. Chairman, the average size of plans I represent today is 32 employees. We are very familiar with the under-100 situation. We happen to be somewhat unique in the way that we function. But I think the statement that under-100 plans are not required to file audit statements, although it is correct, is perhaps not quite a true reflection of what they are required to do.

All plans are required to file a 5500, granted 5500(r)s are filed in 2 out of 3 years and then 5500(c)s filed for the third year. The 5500(R)s beginning this year which are used by the under-100 group contain financial information. They did not used to. I think that is a valuable step in curing the problem that you are addressing. This year is the first time the 5500(R)s have contained financial information. That is a good step.

Mr. Hughes. Mr. Friedman, how were the abuses in Local 109 detected? What was the tip off that basically suggested that something was wrong with Local 109's pension plan?

Mr. Friedman. What happened, Mr. Chairman, first of all, was the failure to file the Form 5500 and the repeated stonewalling of Mr. Benjamin to respond to the request of the Department. Eventually they sent an auditor in who began to poke around. It was just so glaring. That is when it was referred to criminal prosecution.

Mr. Hughes. It was an auditor from the PWBA that came in and detected it?

Mr. **Friedman**. Yes. His initial contact with Mr. Benjamin was sometime in mid-1984. He really did not come to the conclusion that something was awry until probably early in 1986. Within a month thereafter, the criminal investigation began. The search warrant was issued for the premises of the funds.

Mr. **Hughes**. What was the search warrant for? Mr. Brown, at the Midlantic Bank, what was he convicted of?

Mr. **Friedman**. I do have that information here, conspiracy to embezzle from pension funds, five counts. Two counts were conspiracy to embezzle from the pension and welfare fund and the others were actually embezzlement. He was tried and convicted and given a probationary term.

Mr. **Hughes**. Was he the only one at Midtlantic identified?

Mr. **Friedman**. Yes. He was Vice President and Branch Manager.

Mr. **Hughes**. I gather the system was that Mr. Benjamin would send individuals in who had no financial banking, who didn't seem to have the wherewithal to pay bank loans and they were allowed to borrow money and very few questions were asked.

Mr. **Friedman**. That is the scheme.

Mr. **Hughes**. The CD's from the pension plan were pledged as collateral.

Mr. **Friedman**. Yes.

Mr. **Hughes**. From time to time, Mr. Benjamin would pay off out of the pension funds the loans to the bank?

Mr. **Friedman**. No, what would happen was from time to time he would pay them off. What was more likely to happen was that he would not pay them off and the banks would then proceed against the collateral. They would seize the underlying CD's and say it was theirs because the loans had not been paid off.

Mr. **Hughes**. Would the branch manager be the one who would send out the letters?

Mr. **Friedman**. I am not sure how that occurred. It struck me as being rather strange. I don't know how their lending committee reviewed these loans.

Mr. **Hughes**. That is what I am getting at. I don't know where the lending committee was.

Mr. **Friedman**. That is a good question. We are trying to find the answer to that.

Mr. **Hughes**. Your testimony is that the criminal sanctions worked very well here. Benjamin and Brown in particular were prosecuted and convicted. They were convicted. At least one of them went to jail. But there was no follow up on the civil side and there has been none to date. If it were not for the fact that the new pension trustees and planning managers had not pursued the simple remedies against the bank and others who might have been involved, there would have been no recovery; is that your testimony?

Mr. **Friedman**. Yes, Mr. Chairman.

Mr. **Hughes**. I gather Mr. Brown and Mr. Benjamin were both judgment proof.

Mr. **Friedman**. Yes, as was Mr. Paunullo.

Mr. Hughes. Do you envision it would be the responsibility of PWBA to pursue remedies against third parties or is that the responsibility of the trustees of the funds?

Mr. Friedman. I believe in this instance, Mr. Chairman, it is the responsibility of the PWBA to proceed against the lending institutions.

Mr. Hughes. Against anyone who participated in the fraud?

Mr. Friedman. Yes.

Mr. Hughes. Have you been able to get a satisfactory answer from the PWBA as to why it has taken them so long to pursue the civil remedies?

Mr. Friedman. No.

Mr. Hughes. So even though the court basically in this instance made as a condition of probation restitution by the defendants, that has not been forthcoming?

Mr. Friedman. That is correct, Mr. Chairman.

Mr. Hughes. Are there any other third parties besides the Midtlantic Bank that has exposure and, of course, the parties to the fraud and conspiracy?

Mr. Friedman. There are a number of other entities. At the present time we are reviewing all avenues of recovery. Suffice it to say there are other entities besides the lending banks who we believe have some exposure.

Mr. Hughes. I was also interested in your suggestion that the PWBA could not pursue any civil remedies until the criminal matter was disposed of. Why?

Mr. Friedman. Mr. Chairman, the problem that you have is that the information which the PWBA would be privy to, be able to use in a subsequent investigation, might have come out of the grand jury transcripts. As long as these individuals have not been convicted, as long as their appellant rights have not been finished, they could not use the grand jury transcripts. The effect of that could have impacted on the criminal investigation.

Mr. Hughes. I understand that. We would not want to see any civil recovery compromised or undermine in any way an ongoing criminal investigation. I am not suggesting that. I think that is a proper procedure. But absent the need for grand jury testimony and present additional civil evidence that is available, why couldn't they move in tandem? Why do we have to wait for a criminal disposition?

Mr. Friedman. They won't have to. They didn't have to.

Mr. Hughes. Mr. Holland, thank you for joining us today. I know you have come a long distance to share with us your experience in Georgia. I was fascinated about your testimony with Omni because we had an Omni facility in my own Congressional District. The answer is, I suppose, we need to look at covering at the Federal level such supplemental plans, the multiemployer welfare plans. They are in great number around the country. The bottom line is there is no reason why somebody should not be looking at those plans as well.

Mr. Holland. That is my recommendation, Mr. Chairman. I am concerned with the 5500s. I hear about all of these audits. The 5500s I reviewed don't take much auditing, the ones I have here, e.g., we have now an action against one out of Kentucky.

Here is the marketing material that was presented to potential clients. Just for a moment I want to read an excerpt. This is from their vice president chief financial officer that says, "NBA group today has the resources to meet all of its long- and short-term goals to achieve strong growth with excellent stability." You go to their 5500 and you don't need a CPA—I am not a CPA; our investigator is not a CPA—you look at net assets on their 1988 5500. It is a bankrupt entity with negative assets of $750,000 plus.

I am amazed about the audits I am hearing about today. I am not encountering that problem in the State of Georgia with the multiple employer welfare arrangements we are confronting. These people are basically starting an insurance company, marketing that product through insurance agents, which I have grave concerns about, with no assets. To get them started they pay commissions to agents as high as 59 percent. I have an example of that, first year commissions. This is ridiculous. No actuary has reviewed their premium rates. They just print up slick marketing materials and get some of our very uninformed insurance agents to sell it, to their regret. That is a point I wanted to make sure I made.

Mr. **Hughes**. You made it very well.

Mr. Walker, you don't have any employer benefit plans like that, do you, with negative cash flow and they are bankrupt? I trust you don't.

Mr. **Walker**. Thank you for stating my position, Mr. Chairman. No, sir, we do not. We are extremely well funded and every plan we have is actuarially sound.

Mr. **Hughes**. The multiemployer-multibenefit arrangements are required to file Form 5500s. You submitted some. The question is who is looking at them in attempting to make some decisions and what criteria do we use to determine whether or not they should be in business? They should not be in business to begin with if they have to rely upon employer-employee applications for the cash flow to run the program, I am not sure they should be in business to begin with; do you agree?

Mr. **Holland**. I certainly agree with that. That is a very dangerous situation from day one.

Mr. **Hughes**. Mr. Capelli, I thank you for your testimony likewise. I welcome, really, the cooperation that you have offered to the Department of Labor and to the Inspector General's Office in trying to craft some things that make sense to deal with some of the problems. One of the suggestions you made in your statement which you did not mention today is the whole question of accountant-client privilege. How much of a problem is that?

Mr. **Capelli**. It is a major problem from the professional standpoint with respect to our code of conduct and our requirements to protect our client's interest. But as I alluded to in my summary remarks, Mr. Chairman, there have been and continue to be agency interests protected and agencies receiving reports from the independent accountants. Such reports are admittedly addressed to management or the parties or the stockholders, but because of the regulatory requirements those reports are made available to the regulatory agencies almost simultaneously. So all the information on whatever areas of concern or compliance interests the agency has, they are made aware of findings with respect to those areas immediately.

As you know, the Labor Department has instituted a requirement in its own 5500 to be advised of any terminations or any changes in professional advisers or professional service providers. It is also like the SEC requirement that the service provider make a positive statement that they are in agreement with the cause.

In the case of the Local 109 situation at the time the 5500 was filed the professional advisers would have a notice on the department's desk rather shortly after their termination. To the extent there was a red flag because of that notice, the department would have had an opportunity to act on it.

Mr. HUGHES. I take it the public accountants can and should do more to see if we cannot serve the public interest by providing information at a timely fashion to the Department of Labor where there are things that seem to be out of order, where there is not plan compliance or discrepancies that are irreconcilable.

Mr. CAPELLI. I don't think there is any question, again, that our record speaks for itself. We have been on record since 1978 with the suggestion that we can extend the scope of our work to cover all the assets, all the information, financial information included in the 5500 filing.

We have adopted on our own procedures that would make that cost-effective from an auditing standpoint so that the plans and the sponsors of plans need not unreasonably carry costs to accomplish the full scope audit. We can and have with other agencies and are willing to, with the Labor Department, devise compliance-type reporting procedures to report on anything within our scope of competence that the department needs to be assured of or have an additional amount of comfort about.

Mr. HUGHES. Mr. Walker, you expressed some concern over the possibility of plan managers perhaps interpreting the results and regulations one way in good faith and an independent auditor, public accountant, interpreting it another way in creating basically a lot of additional work unnecessarily.

Isn't that an area where the Department of Labor could be of some help in propagating guidelines in areas where its adjustment call on information required and the proper techniques? It seems to me the DOL can provide a lot more guidance than they obviously have in the past for program managers in what they expect in Form 5500. Wouldn't that minimize that?

Mr. WALKER. It would certainly be helpful. When I speak in terms of the various problems that could occur, I think of the current situation on 401K loan provisions where IRS says A participant can borrow $10,000 without restrictions and the DOL says if they are going to use plan assets as collateral they can only borrow one half of the account.

The Department of Labor position is one that is now 4 to 6 weeks old. Most plans have been operating with the IRS regulation in loaning out the full $10,000. Had an auditor taken the position the Department of Labor took before such time as the Department of Labor clarified their position, would there have been a potential for an IPA reporting a plan administrator? I think so. I am not sure that that is the kind of end result that you are after. I think it is the kind of end result you could very well get.

Mr. **Hughes**. It seems to me that a major part of the problem, and you put your finger on it, Mr. Walker, as have other witnesses, we have not done a very good job of administering the program to begin with. They appear to have civil war at the Department of Labor. That is not unusual. Turf battles are commonplace here in Washington. I deal with it all the time in the enforcement community generally among law enforcement agencies.

However, it seems to have reached a rather acute stage at Labor. That needs to be addressed. That is part of the problem. They have a research problem. I don't know how they can possibly expect to deal with $1.7 trillion in assets and do a decent job with 270 compliance inspectors. It is absolutely impossible.

While we can get public accountants to do more and require them to—and review many of our policies with limited scope reviews, et cetera, it seems to me that we need to develop integrated and sophisticated computerized strategy within the Department of Labor that can identify problem areas so that we have a quicker turnabout. I am also persuaded that the strategy at DOL has unfortunately been too heavily weighted in the civil area and not enough weight in the criminal area for those more egregious-type of offenses that need to be pursued criminally.

I don't know what the numbers are going to look like, but I am going to ask the General Accounting Office to provide for us an analysis of those some 1,200 cases so we can see from a cross section how much of those should have been referred to the Justice Department for criminal prosecution. There is nothing like sending the Benjamins to jail or the Browns to jail to send a very clear signal that there is no difference between bilking poor working people of their life savings, their contributions to a welfare plan, than there is to hold a gun to their head when they leave work at night and take their money that way.

The net effect is still the same, even more disastrous because unfortunately while their life is in jeopardy when they take money with a gun or in a burglary at least it is a limited amount. But here it represents perhaps 25 years savings for that rainy day when they are going to need it.

We need to review a whole host of issues and you have helped us focus on many of those issues that this committee is going to take a look at.

Thank you. We appreciate your assistance.

That concludes our testimony and the subcommittee stands adjourned.

[Whereupon, at 2:10 p.m., the hearing was adjourned.]

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APPENDIX

APPENDIX 1

CHANGES ARE NEEDED IN THE ERISA AUDIT PROCESS TO INCREASE PROTECTIONS FOR EMPLOYEE BENEFIT PLAN PARTICIPANTS

U.S. DEPARTMENT OF LABOR
OFFICE OF INSPECTOR GENERAL

Report Number: 09-90-001-12-001
Date: NOV 9 1989

U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210

NOV 9 1989

Reply to the Attention of:

MEMORANDUM FOR: DAVID BALL
Assistant Secretary for Pension and
Welfare Benefits

FROM: GERALD W. PETERSON
Assistant Inspector General
for Audit

SUBJECT: Changes are Needed in the ERISA Audit
Process to Increase Protections for
Employee Benefit Plan Participants
Final Report No. 09-90-001-12-001

We completed an audit of the quality of benefit plan audits, performed by Independent Public Accountants (IPAs) to determine if their work met ERISA requirements.

The results of our review disclosed that:

-- DOL requirements for benefit plan audits should provide stronger protections for participants and their beneficiaries;

-- IPA audits of plans covered by ERISA need improvement to consistently comply with GAAS as required by ERISA; and

-- IPA-prepared reports for employee benefit plans generally do not meet ERISA disclosure requirements and standards.

In order to make the IPA function more effective in protecting participant rights and benefits, we recommend that PWBA:

-- propose legislative changes to ERISA to require full scope audits of plans with more than 100 participants;

-- require direct reporting of ERISA violations by IPAs to senior management and to the board of directors or its audit committee and to PWBA for action;

-- require ERISA compliance testing and reporting by IPAs;

-- work with the AICPA to improve compliance of plan audits and reports with GAAS and ERISA;

-- expand its quality review procedures to include ERISA audit workpapers; and

-- use its existing enforcement authority, when appropriate, to obtain quality audits and reports on plan operations.

In your response you expressed agreement, in principle, with the concerns raised by our report and were working to find solutions and, where feasible, implement our recommendations. You also suggested that OIG would be invited to participate in analyzing the issue of compliance testing. OIG would gladly participate in this and other matters relative to our recommendations and await further details from you.

In accordance with DLMS 8-500, "Audit Resolution and Followup," we would appreciate your written response to the final report within 60 days. Your response should address the status of planned actions for each recommendation.

If you have any questions, please contact Robert Curtis at 523-8401.

Attachments

TABLE OF CONTENTS

	PAGE
ACRONYMS	ii
EXECUTIVE SUMMARY	1
FINDINGS AND RECOMMENDATIONS	4
I. Legislative and regulatory requirements for benefit plan audits need changes to provide stronger protections for participants and their beneficiaries	4
II. IPA audits of plans covered by ERISA need improvement to consistently comply with GAAS as required by ERISA	18
III. IPA reports for employee benefit plans do not meet ERISA or DOL requirements	26
APPENDIX A - BACKGROUND, OBJECTIVES AND SCOPE, AND SAMPLING METHODOLOGY	32
APPENDIX B - PWBA's Comments on Draft Report	36

ACRONYMS

AICPA	American Institute of Certified Public Accountants
DOL	Department of Labor
ERISA	Employee Retirement Income Security Act of 1974
FDIC	Federal Deposit Insurance Corporation
FHLBB	Federal Home Loan Bank Board
FRB	Federal Reserve Bank
GAAS	Generally Accepted Auditing Standards
GAAP	Generally Accepted Accounting Principles
IPAs	Independent Public Accountants
IRS	Internal Revenue Service
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
PBGC	Pension Benefit Guaranty Corporation
PWBA	Pension and Welfare Benefits Administration
SAS	Statement on Auditing Standards
WPPDA	Welfare and Pension Plans Disclosure Act of 1958

EXECUTIVE SUMMARY

The Office of Inspector General (OIG) has completed an audit of the quality of audits performed by Independent Public Accountants (IPAs) on private pension and welfare benefit plans.

We did this work for four compelling reasons. First, approximately 66 million American workers and retirees are depending on the financial integrity of these benefit plans. Second, assets held by these plans now total nearly 2 trillion dollars. Third, adequate oversight of employee benefit plans is at least partially dependent on good audit coverage. And fourth, our prior audit work since 1984 identified significant problems with plan audits by IPAs which have gone largely unresolved.

The Congress, in passing the Employee Retirement Income Security Act (ERISA), intended that annual plan audits be conducted **on behalf of the participants.** These audits were intended to not only scrutinize plan transactions and operations but to make certain **disclosures to plan participants so that they could self-police their own plan.** Therefore, the primary objective of our audit was to assess the degree of information and protection that IPA audits currently provide plan participants.

Our audit work included examining information contained on Forms 5500, plan financial statements, the IPA report and the IPA's workpapers. Our examination of a randomly selected, statistically valid sample of 279 plans revealed inadequate protection for plan participants and their beneficiaries. We found that ERISA and DOL requirements must be revised and enforcement of American Institute of Certified Public Accountants' (AICPA) standards strengthened to ensure adequate audit coverage and the protections envisioned by Congress.

We are convinced changes need to be made for three major reasons:

1. Current "limited scope" audits of pension and welfare benefit plans do not adequately test transactions or plan assets.

2. IPA audits do not consistently meet professional standards (Generally Accepted Auditing Standards (GAAS)) and the Pension and Welfare Benefits Administration (PWBA) is not enforcing existing ERISA requirements that IPAs meet these standards.

3. IPA audits are not disclosing information to plan participants or rendering opinions on information accompanying a plan's financial statements as required by ERISA.

"Limited Scope" Audits do not Adequately Test Transactions or Plan Assets

Foremost among the reasons for changing ERISA and Department of Labor (DOL) requirements is the fact that ERISA currently allows plan administrators to tell auditors to skip the testing of assets held in trust by banks and other regulated financial institutions. IPAs call this limit on their testing a "scope limitation."

When the IPA's scope is limited, they generally "disclaim" any opinion as to whether the financial statements are correct. In all plan audits with this type of "scope limitation," we found that the IPA issued a disclaimer of opinion. It is important to realize that a disclaimer of opinion is synonymous with no opinion at all. What comfort can a "no opinion" audit give plan participants or trustees?

We believe this discretion to limit the scope of audits was given plan administrators because of a belief that regulated financial institutions, like banks, were heavily audited by the Federal Government. While this may have once been true, it is not true today.

We found that 127 of the 279 IPA audits, **or almost half** of those we examined, had this "scope limitation." The result was that in our audit universe, $4.2 billion out of $9.8 billion in plan assets (43 percent) were never audited. We believe that 43 percent of employee benefit plan assets escaping audit scrutiny is unacceptable. (See page 4 for details.)

IPA Audits do not Consistently Meet Professional Standards and PWBA is not Enforcing ERISA Requirements That They Do

The second reason change is needed is that IPA audits do not consistently meet GAAS, despite ERISA requirements to do so. Our review of IPA workpapers on audits of the 279 plans disclosed that 64 (23 percent) did not meet one or more of the GAAS elements. There is a lack of monitoring of IPA audit work by the Pension and Welfare Benefits Administration (PWBA) and a lack of feedback from PWBA to IPAs regarding audit quality. Hence, IPAs give a low priority to ERISA audits. As a result, IPA audits do not provide intended protection of participant rights and benefits and cannot be relied upon to provide adequate testing of financial and compliance control systems. (See page 18 for details.)

IPA Audits are not Disclosing Information or Rendering Opinions on Information Accompanying a Plan's Financial Statements as Required by ERISA

The third reason change is needed is that IPA audits are not providing required disclosures or giving required audit opinions on information accompanying a plan's financial statements. Our audit work revealed that 181 (65 percent) of the reports did not meet these ERISA or DOL requirements. Additionally, there has been a lack of enforcement from PWBA and the Internal Revenue Service (IRS) when incomplete or incorrect information is submitted. Consequently, plan participants are not receiving the information or protections of full disclosure as Congress intended. (See page 26 for details.)

Recommendations

To make ERISA auditing more effective in protecting participant rights and benefits, we recommend that PWBA:

- propose legislative changes to ERISA to require full scope audits of plans;
- require direct reporting of ERISA violations by IPAs to senior management and to the board of directors or its audit committee and to PWBA for action;
- require ERISA compliance testing and reporting by IPAs;
- work with the AICPA to improve compliance of plan audits and reports with GAAS;
- ensure PWBA quality review procedures include audit workpapers; and
- use its existing enforcement authority when appropriate to obtain quality financial statements, audits, and reports on plan operations.

FINDINGS AND RECOMMENDATIONS

I. LEGISLATIVE AND REGULATORY REQUIREMENTS FOR BENEFIT PLAN AUDITS NEED CHANGES TO PROVIDE STRONGER PROTECTIONS FOR PARTICIPANTS AND THEIR BENEFICIARIES

Current ERISA and DOL audit requirements should be revised to provide stronger protections for plan participants and their beneficiaries. Specifically, revised requirements should include (1) full scope audits for all benefit plans with over 100 participants, (2) direct reporting of ERISA violations to parties independent of plan administration and to PWBA, and (3) ERISA compliance testing and reporting.

Changing the audit requirements to include the above would provide more complete audit coverage of plan assets and transactions with increased reliability as to propriety and fairness of plan activities. It would also fill a void in evaluating compliance control systems and would increase the scrutiny of plan fiduciaries and administrators. It would also assist PWBA in detecting and correcting noncompliance with ERISA. Finally, direct reporting to parties above plan administrators and to PWBA would assist PWBA and oversight officials to implement corrective actions.

Full Scope Audits are Needed to Increase Protection

Under ERISA, Section 103 and 29 CFR 2520.103-8, a plan administrator may elect to exclude certain information from the IPA's examination. Generally, if a plan's assets are held in a bank or similar institution, the plan administrator may elect to have information certified by the institution not subjected to audit.

The legislative intent of this provision was to exempt institutions that were already examined by Federal or state agencies from duplicative detailed audits. However, we believe that this provision no longer serves the purpose intended and increases risk to plan participants.

As discussed in the following paragraphs, this is because (a) there is minimal audit coverage to be duplicated; (b) assets held by banks and similar institutions are subject to abuse and mismanagement and, therefore, need ERISA audits; (c) limited scope audits are not useful to DOL, plan participants and beneficiaries; and (d) a very significant amount of plan assets are not audited.

(a) **Minimal Audit Coverage** -- Banks and similar institutions are generally audited by one of several Federal agencies - the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), the Federal Reserve Bank (FRB), or the Federal Home Loan Bank Board (FHLBB). These agencies have widely varying audit coverage:

-- FDIC used to audit each FDIC-insured bank every year. Currently, however, the audit frequency is dependent on past audit results which are translated into a rating for each bank. Generally, an audit is conducted once every 2 years. The FDIC has a limited audit procedure designed to test a bank's trust department's transactions that is insured by FDIC. However, none of the audit steps are specifically designed for testing ERISA plans.

-- OCC audits banks with a national charter and used to perform audits every 2 years. Currently, however, it has an audit sampling system in place. With this sampling system, there is no set frequency for covering each bank. Therefore, while some banks may, by sampling chance, get reviewed frequently, some may go many years without a review. It is possible that poor trust departments from an ERISA standpoint, may go unaudited for years. Also, the OCC trust specialists have decreased from over 2,500 several years ago to only about 50 currently.

-- FRB is responsible for all state-chartered banks that are members of the Federal Reserve System. The frequency of examinations ranges from annually to every 3 years depending on the rating assigned to the member bank. During their reviews of trust departments, FRB does consider ERISA compliance to the degree that employee benefit trusts are included in the review sample.

-- FHLBB is responsible for all thrift institutions that are insured through the Federal Savings and Loan Insurance Corporation. There are fewer trust departments at these institutions than in banks due to the relatively late entry into the trust market by thrift institutions such as Savings and Loans. However, the number of trusts maintained by thrift institutions increased 87 percent in 1986 over the previous year. In 1986, $12.9 billion was held by FHLBB institutions for employee trusts. Until recently, the FHLBB had no trust specialist or audit procedures in place for examinations of Savings and Loans trust departments. Therefore, there have been no reviews of employee benefit trusts in these institutions since their entry into the market in 1981.

As can be readily seen, banks and similar institutions are not receiving annual audits from Federal agencies in a way that adequately considers ERISA requirements.

While banks and other financial institutions are not audited annually by Federal agencies, most are audited annually by internal and independent public auditors. In addition, those banks under the OCC are required to have an annual audit of their trust department. However, these audits do not specifically consider ERISA requirements nor are the results necessarily provided to a party in a position to act on behalf of plan participants. For example, many of the trust departments are audited by the internal auditing group of a bank holding company. The guidelines we reviewed for these audits do not indicate any consideration for ERISA. Also, these reports are internal to the bank, although copies are available to the Federal financial regulatory agencies. The reports, however, are not available to outside plan auditors, DOL, or any other party with an interest in a specific plan's assets.

Therefore, whatever the audit coverage situation may have been in 1974 when ERISA was enacted, we believe that there is now inadequate audit coverage of ERISA plan assets held in trusts by banks and similar institutions. To require audit coverage of these assets in banks or other institutions would not be duplicative and would provide additional protection of plan assets, through increased scrutiny, that does not now exist.

(b) **Abuse and Mismanagement at Financial Institutions** -- Plan assets held in trust by banks and similar institutions are subject to risks of abuse and mismanagement, as are assets held by others. Therefore, there is no legitimate reason to exclude financial information from banks and similar institutions from IPA audit examination.

During our review, we noted that the FDIC, over an 8-year period, had referred 135 cases of potential ERISA violations to DOL. These violations were discovered during their periodic examination of banks. Samples of the violations are:

a. A bank invested about $727,000 from five separate plans in "investment notes" issued by an affiliate of the fiduciary bank. This is not a proper investment since the bank was affiliated with the company being invested in. For all these plans, the notes represented over 50 percent of the plan assets.

b. A bank loaned almost $600,000 to various parties without the plan's direction. Also, the loans were junior lien loans which the FDIC considered imprudent.

The well-publicized problems in the Savings and Loan segment of the industry further illustrates the problems that can occur as a result of poor execution of responsibilities on the part of banks and similar institutions.

As previously noted, plan assets and transactions in trust departments are not audited annually as are assets held by the plan. This allows billions of plan dollars to go unaudited with the resulting lack of protection and assurances for plan participants and beneficiaries.

(c) **Limited Scope Audits are not Useful** -- Limited scope audit reports are not useful in terms of information or protection provided to participants and beneficiaries. This is because they do not contain any IPA assurances on the reliability of the financial information presented.

When an IPA is restricted from examining necessary information in an audit, the audit report generally contains a disclaimer of opinion. Basically, this is a statement from the IPA that he can not provide assurances on the financial statements because the plan administrator, as allowed by DOL regulations, restricted the scope of the examination. In essence, there are no assurances that the statements are right or wrong. This disclaimer of opinion also extends to the ERISA-required schedules prepared by plan administrators, such as the schedule of transactions with parties-in-interest.

This type of opinion does not address the needs or concerns of DOL nor plan participants and beneficiaries. All users are left with financial statements that have no assurances as to their fairness or completeness.

In addition, we noted that some IPAs perform very little work in any area of the plan operations when they know they will issue a disclaimer on the overall financial statements. For example, one IPA did not test beneficiary payments, contributions, or other parts of the plan which should have been reviewed even with a limited scope. The IPA's response for not conducting these tests was that he knew a disclaimer would be issued because of the scope restriction placed on him by the plan administrator. Therefore, the lack of testing had no further effect on his opinion. Since a disclaimer was issued, there was little liability for lack of testing and the IPA perceived little likelihood of professional censure since no opinion was expressed.

(d) **Significant Amount of Plan Assets are not Audited** -- Of 279 plan audits reviewed, 127 (46 percent) were limited scope and contained disclaimers of opinions on their financial statements. These plans held assets totaling $4.2 billion (43 percent) out of a total of $9.8 billion in our sample. The following table shows where the limited scope audit plan assets were held:

Schedule of Limited Scope Audit Assets
by Regulated Industry

Regulated Industry	Total Plan Assets	Percentage of Total	Number of Plans	Percentage of Total
Trust Cos.	$3,302,282,287	78.51	28	22.04
Banks	539,656,030	12.82	75	59.06
Insurance	62,535,322	1.49	9	7.09
Savings & Loan	28,202,650	.67	6	4.72
Other	836,455	.02	1	.79
Dual Trustees:				
Trust/Insur.	239,584,290	5.70	1	.79
Bank/Insur.	22,243,379	.53	6	4.72
Union/Insur.	11,091,282	.26	1	.79
Totals	$4,206,431,695	100.00	127	100.00

As previously stated, in 46 percent of the plans, covering 43 percent of the assets, the plan administrators elected to use the limited scope approach. This means that almost half of all plan assets are not examined by plan auditors or reported on to DOL or plan participants. To improve assurances to DOL and plan participants, PWBA needs to eliminate the provisions for limited scope audits and provide for full scope audits of plan assets and transactions.

Reporting ERISA Violations

PWBA does not require direct reporting of ERISA violations noted by IPAs in their audits of benefit plans to itself or parties above the level of plan management involved. Instead, PWBA relies upon plan administrators to partially report their own violations on Form 5500. This places total reliance on the plan administrators to report their own violations, which they have not done consistently. This significantly hampers PWBA's ability to quickly respond to identified problems to ensure they are corrected and participant interests are protected. Also, participants are not fully informed as to their plan(s) operations.

ERISA, Section 103(a)(3)(a), provides that plan administrators engage IPAs to audit plans **on behalf of participants.** It is the plan participants who have a primary interest in the plan(s) financial condition and operation. ERISA also specifies that it is DOL's responsibility to oversee the plans on behalf of the participants to ensure the participants' interests are protected. Yet, under current procedures and regulations, neither the plan participants nor DOL are directly informed of ERISA violations when discovered.

Currently, IPAs generally consider the plan sponsor or administrator as the client and reports are generally addressed to plan administrators. The plan administrator is responsible for submitting the audit report and accompanying financial statements and schedules with a Form 5500 as part of the plan's annual filing to the Internal Revenue Service (IRS). IRS encodes the information from the Form 5500 **prepared by the plan administrator** into its computer system and provides the computerized information to PWBA on a quarterly basis. The IPA report and Form 5500 are eventually sent, through a microfiche contractor, to PWBA.

There are several major problems with this process. First, it takes about 2 years from the end of each plan's fiscal year for the annual report to get to PWBA. This includes a 210-day grace period for filing the Form 5500 and then processing delays at IRS and PWBA, including its microfiche contractor. With this kind of delay, any information PWBA receives concerning ERISA violations is outdated. This makes it extremely difficult for enforcement and corrective action.

Even then, the process does not consistently alert PWBA to ERISA violations. Form 5500 information, which is entered into PWBA's computer system, contains very limited information regarding ERISA violations, such as party-in-interest transactions. There are other potential ERISA violations which could be reported by IPAs, such as fiduciary violations, which are not represented on Form 5500.

In addition, Form 5500 is prepared by the plan administrators who are essentially being asked to **report their own violations.** Our review showed that plan administrators are not properly completing Form 5500 to show violations. Specifically, we found 5 cases where plan financial statements showed nonexempt party-in-interest transactions, but the Form 5500 prepared by the plan administrator stated there were none. Even though both documents are prepared by the plan administrators, they contained conflicting information. There is a basic flaw in any control system which asks individuals to report their own violations.

Finally, the sheer number of reports prevents PWBA from reviewing each report for reported ERISA violations. Generally, reports are received by PWBA's Division of Reports and are stored away without a review by or referral to PWBA enforcement personnel. Thus, even if IPAs disclosed violations in their reports, there are no assurances PWBA would detect the disclosure.

As a result, PWBA has not been consistently and completely informed of ERISA violations contained in audit reports and has not been able to act upon them in the interest of plan participants or beneficiaries. Also, since the plan administrator receives and files the IPA reports, the plan participants, on whose behalf the audit was done, do not generally see the report and are not informed timely.

For example, in our review, we found financial statements in two annual reports which disclosed potential ERISA violations other than party-in-interest transactions required to be reported on Form 5500. Specifically, the financial statements disclosed:

-- One plan was not in compliance with fidelity bonding requirements of ERISA.

-- One plan had purchased more than 10 percent of the plan sponsor's stock in violation of ERISA.

These annual reports, including financial statements with IPA audit reports, were filed in accordance with existing procedures with IRS and, eventually, were forwarded to PWBA. However, again in accordance with existing procedures, the reports were apparently received and held in the Division of Reports. The violations were never specifically brought to PWBA's Office of Enforcement and no action was ever taken to protect the participants' interests by correcting the violation.

PWBA could have acted upon these violations in a decisive manner had the violations been reported directly to parties above the plan management involved and to PWBA. While the volume of plans is too large for PWBA to obtain all plan reports directly, it is possible to require IPAs who have reason to believe an ERISA violation occurred to inform parties above the level of plan management involved and PWBA for action.

Additionally, control and influence would be enhanced if plan participants had a separate party, such as an audit committee or board of trustees, acting on their behalf. As it now stands, audit matters are generally reported to plan administrators or sponsors. Due to their lack of independence and potential involvement in violations disclosed, neither of these parties should be expected to act on behalf of plan participants.

Current ERISA provisions specify that the IPA performs the required audits for the participant and, therefore, the participant is the client. Thus, the participants, or a party acting as their agent, should be informed of ERISA violations. Further, DOL is fully empowered by Congress to act on behalf of the participant and should receive information that identifies potential threats to the participant's benefits.

Direct reporting of ERISA violations to uninvolved parties and DOL is in consonance with a recommendation of the DOL ERISA Task Force organized in 1984. Recognizing the IPA as an existing private-sector resource with enormous potential to immediately enhance the enforcement of ERISA, the Task Force recommended that IPAs report violations directly to DOL. This recommendation, however, was never implemented.

In addition, as discussed in the following paragraphs, the AICPA has taken actions recently which support the need for IPAs to detect and report ERISA violations to parties not involved in the violations.

The Auditing Standards Board has recently issued several new Statements on Auditing Standards (SASs) to address issues raised by Congress and others. These have a direct impact on IPA reporting under ERISA.

Specifically, SAS No. 53 - The Auditor's Responsibility to Detect and Report Errors and Irregularities provides guidance on the independent auditor's responsibility for the detection of errors and irregularities, and communication of detected matters.

This SAS requires that the IPA communicate irregularities to parties above the level of management involved in the irregularity. An audit committee, board of trustees or other independent party such as DOL acting on behalf of participants would provide an excellent level of control and scrutiny for employee benefit plan participants.

In addition, SAS No. 54 - Illegal Acts by Clients prescribes the procedures to be followed when an illegal act, such as an ERISA violation, is detected during an audit. Again, this SAS requires that the auditor report the possibility of the illegal act to a party, such as an audit committee, which is above the level of management involved.

An audit committee, board of trustees, or PWBA, acting on behalf of the participants, would be an excellent tool for communicating audit results to participants. Also, PWBA could require audit committees or boards to forward suspected ERISA violations directly to PWBA which would improve enforcement targeting and respond to suspected plan problems. In accordance with the SASs, illegal or irregular acts could be brought to the attention of an uninvolved party, including PWBA, during the audit field work. This would speed the reporting of the violation directly to PWBA and would eliminate reliance on the plan administrators for self-reporting of violations. Overall control of and corrective action on violations would be greatly enhanced.

ERISA Compliance Testing

DOL regulations do not require the testing for or reporting of ERISA violations. As a result, IPAs do not perform significant testing for ERISA compliance. Therefore, ERISA noncompliance is rarely found or reported.

AICPA guidelines do suggest that IPAs be alert to possible fiduciary breaches and prohibited transactions. Specifically, Section 11.6 of the AICPA's audit guide recommends that, with respect to prohibited transactions, plan examinations normally should include the following:

-- inquiring of company and plan officials about activities or transactions which might be prohibited;

-- obtaining from the plan administrator a list of all parties-in-interest; and

-- determining whether any prohibited transactions have been disclosed as a result of past IRS or other governmental examination.

Other audit procedures for identifying noncompliance with ERISA include client representation letters from the plan administrator, trustees or administrator agents. In these letters, plan officials are asked to certify to the correctness of bonding requirements, the plan's tax exemption status, and other related matters.

The AICPA guidelines generally allow the IPA to rely on the statements of the plan sponsor or administrator as to whether the plan violated ERISA, another instance of self reporting. The guidelines state that the IPA should become aware of material violations during normal financial testing. However, specific testing for ERISA compliance is not required and is, therefore, not generally performed. Unless the IPA is specifically testing for ERISA compliance, it is likely that violations will be overlooked. In our opinion, IPAs should do significantly more for the plan participants.

This view is similar to one expressed by PWBA. In an October 20, 1988 letter to the AICPA, PWBA stated that the revisions to the guidelines which were being considered should require the IPA to examine the client's control procedures with respect to compliance with ERISA and plan documents. We concur in this position and further believe specific testing of transactions for ERISA compliance is needed.

Due to the lack of compliance testing, little noncompliance with ERISA is detected by IPAs. In the sample reviewed, only two reports specifically identified certain transactions as ERISA violations. However, when we reviewed the IPA reports and workpapers for ERISA compliance, with no additional audit testing, we identified an additional 18 cases of potential ERISA violations.

In addition, prior OIG reviews of IPA work identified 62 plans where PWBA or OIG found violations totaling $18.7 million. In the IPA audits of these 62 plans, 54 of the IPAs did not detect and/or report the violations. This clearly shows the need to require ERISA compliance testing and reporting by IPAs.

Conclusions -- PWBA needs to change the regulations to better protect plan participants and beneficiaries. Limited scope audits are not providing adequate protection for plan assets held in trust by banks and similar institutions. The audit coverage assumed to exist in the banking community does not exist. Therefore, PWBA needs to take action to ensure the audit coverage is provided.

In addition, PWBA needs to take action to improve the detection and reporting of ERISA violations. Noncompliance with ERISA provisions can have a significant impact on a plan's financial information. Reporting of violations to a party not involved in the violation such as an audit committee and/or DOL, acting on the participants' behalf as specified in ERISA, would improve the control of plan audits and operations. Further, if the violations were reported directly to PWBA, action could be taken quickly to protect assets and prevent further violations. In conjunction with this, evaluation of compliance with ERISA by IPAs would provide additional assurances to participants as to the operational integrity of their plans.

RECOMMENDATIONS

We recommend that PWBA:

- propose changes to ERISA to eliminate the provision for restricting the scope of plan audits;
- obtain coverage of ERISA compliance in IPA audits by working with the AICPA on its revision to the audit guide or, if necessary, through regulatory change;
- require plans to establish parties separate from plan management to oversee IPA audits on behalf of participants; and
- require direct reporting of ERISA violations by IPAs to senior management and to the board of directors or its audit committee and to PWBA for action.

PWBA'S RESPONSE:

In response, PWBA stated:

> Limited-Scope Audits
>
> PWBA believes that it may be appropriate to eliminate the limited-scope audit exemption, recognizing that such a change may result in an increase in plan audit costs of 10 to 30 percent. A rough estimate of such increased costs has been provided by the AICPA. We recognize that a high percentage of plans utilize the exception, that the regulatory climate for banks and insurance companies is different (and often less reliable) than that which existed when ERISA was enacted in 1974, and that limited-scope audits conducted under the current rules raise several of the concerns included in the OIG's draft report. It may be necessary, however, to undertake additional empirical study to determine whether the limited scope audit exception should be eliminated.
>
> One potential way to achieve more comprehensive audits, while keeping increased plan audit costs to a minimum, is to use the "single-audit approach." Under this method, the plan's IPA would obtain a special-purpose report from the bank's or insurance company's independent auditor. This report would provide assurances that the necessary procedures and review of the internal control structure of the bank or insurance company had been performed. Those assurances, when coupled with the other auditing procedures performed by the plan's IPA on transaction information, should enable the IPA to render an unqualified opinion on all assets listed on the plan's financial statements. We are working with the AICPA, banking, and insurance regulatory agencies to determine the feasibility of this approach.
>
> Compliance Testing
>
> In each of it's reports, the OIG has recommended that ERISA be amended to require IPAs to test for compliance with the law and regulations, in addition to performing their traditional financial statement audit function. The OIG reports have not, however, indicated the extent of such testing deemed necessary, nor any estimates of its cost -- which would, directly or indirectly, be borne by plan participants and beneficiaries.
>
> It is important to note that the OIG is recommending a major change in government regulatory policy, *i.e.*, shifting some of the responsibility and cost for

determining ERISA compliance from the government to the private sector. Such major increases in the cost of pension administration might have serious effects on the willingness of employers to provide pensions for their workers.

Under existing law, the IPA audit is to be conducted in accordance with generally accepted auditing standards (GAAS). GAAS does not require compliance testing or reporting on compliance with laws and regulations. In auditing the financial statements of an employee benefit plan, the IPA is concerned only with whether the statements fairly present the financial condition of the plan -- not whether the plan complies with the law and regulations, unless any noncompliance "materially" affects the financial statements. Thus, representatives of the American Institute of Certified Public Accountants (AICPA) have advised us that they believe IPAs must, as part of their audit, satisfy themselves that the subject plan has adequate internal controls and procedures in place to permit the plan administrator to comply with legal requirements. But IPAs are not required to test for compliance or to ensure the reporting on Form 5500 of financially "immaterial" illegal transactions.

The range of possible compliance audit requirements is as broad as ERISA is complex. For example, should IPAs be required to test for all possible violations of ERISA irrespective of dollar value, subject matter, or other criteria? Should testing be required for all possible prohibited transactions, including those involving remote parties-in-interest or those which have a positive investment return? Resolution of these difficult issues necessarily involves a careful balancing of potential costs against potential additional safeguards to plan participants and beneficiaries who, in one way or another, will pay the auditing bill. Accordingly, we believe that more analysis must be devoted to this issue before we can definitely answer these questions.

During the coming six months, we will analyze these questions and seek to design a compliance testing program. We will invite the Inspector General to join us in this task, which will also involve other government agencies and the AICPA. Our target date for completing this work is March 15, 1990.

Direct Reporting

In this draft report, as well as in prior reports, the OIG has consistently recommended that PWBA require IPAs to report ERISA violations directly to the Department. The specific recommendations have differed from report to report, but their basic thrust remains the same. While we are not convinced that such a dramatic change in the relationship between accountants and clients is warranted (particularly in light of accountant-client privileges where applicable), we do believe that some changes should be considered, such as requiring the IPA to sign Form 5500 and related schedules that are the subject of his audit. Currently, only the Plan Administrator signs the Form 5500. Clearly, the resolution of the outstanding issues relating to the scope of the IPA's audit will have a direct bearing on the final outcome of this recommendation. The more compliance-oriented the IPA work, the more justification there would be to report items of non-compliance to DOL. In any case, we strongly believe that, to be useful, any such direct reporting must be made within the framework of the annual report. Accordingly, as we work to develop a proposal on the scope of IPA audits, we will include appropriate changes in IPA reporting to DOL either directly or through the establishment of audit committees.

AUDITOR'S CONCLUSIONS

PWBA's proposed corrective actions in regard to limited scope audits are not adequate. Further empirical studies are not needed and would only delay obtaining the necessary audit coverage of plan assets. The AICPA has opposed the concept of limited scope audits since the concept was implemented and has continuously pointed out the lack of coverage and other potential problems. In addition, the concept has been discussed numerous times by the ERISA Advisory Council. The time has come for PWBA to take action.

Unless PWBA is willing to take this action, it should consider eliminating audit requirements for plans with assets held by banks or similar institutions. With almost half of the plans producing disclaimers of opinion, money is being wasted for audits that do not provide any assurances or protections to participants.

We concur with PWBA's proposed actions on obtaining compliance testing and reporting by IPAs. We will be glad to assist in this effort.

On direct reporting, we do not agree with PWBA that any direct reporting should be done within the framework of the annual report. Annual reports are filed by the plan administrators and any reporting of noncompliance would be "self-reporting." Experience has shown that this method is not reliable.

Also, the timeliness of annual reports makes this method undesirable. All violations should be reported at the time of discovery and not be allowed to continue uncorrected, especially if plan assets are adversely affected. The only way to accomplish this is to require direct reporting to DOL through the IPA process, including audit committees.

We agree that the resolution of this issue is dependent on the actions taken relative to the scope of the IPA's work. If compliance testing is required and PWBA implements a compliance testing program, PWBA should also define significant violations and establish reporting requirements.

II. IPA AUDITS OF PLANS COVERED BY ERISA NEED IMPROVEMENT TO CONSISTENTLY COMPLY WITH GAAS AS REQUIRED BY ERISA

IPA audits of employee benefit plans do not consistently meet GAAS despite ERISA requirements to do so. Our review of IPA workpapers on audits of 279 plans disclosed that 64 (23 percent) did not meet one or more of the GAAS elements. There is a lack of monitoring and feedback from PWBA; therefore, IPAs give a low priority to ERISA audits. As a result, IPA audits do not provide intended protection of participant rights and benefits and cannot be relied upon to provide adequate testing of financial and compliance control systems.

ERISA, Section 103, specifically requires that **the plan's annual IPA audit must be conducted in accordance with GAAS.**

GAAS represents criteria used to judge IPA work. As approved and adopted by the members of the AICPA, GAAS consists of (1) general standards, (2) field work standards, and (3) reporting standards.

General standards govern the overall conduct of the audit work. They require (a) adequate technical training and proficiency as an auditor, (b) an independence in mental attitude, and (c) due professional care in the performance of the examination and the preparation of the report.

Field work standards govern the actual audit work. They require (a) the work to be adequately planned and supervised, (b) an evaluation of internal controls, and (c) sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements under examination.

Reporting standards govern the reporting of the audit results. They require the report to (a) state whether the financial statements are presented in accordance with Generally Accepted Accounting Principles (GAAP); (b) identify if such principles have not been consistently observed; (c) provide adequate informative disclosures; and (d) contain either an expression of opinion regarding the financial statements taken as a whole or an assertion to the effect that an opinion cannot be expressed.

Adherence to these standards should provide users of audit reports a high degree of assurance as to the reliability of the information contained in the report.

As previously noted, ERISA requires that these standards apply to plan audits. If audits do not meet ERISA requirements, including GAAS, ERISA specifically gives PWBA authority to take action. The remedies available to PWBA currently are:

-- rejecting incomplete reports and providing plan administrators with 45 days in which to file a satisfactory report;

- retaining an IPA to perform an audit and charge the plan for the audit costs; and
- bringing civil action against the plan for such relief as may be appropriate in enforcing ERISA.

In addition, PWBA can take other action including referring deficient audit work to appropriate professional organizations for review and possible action.

However, our survey disclosed that **IPA audits are not always performed in accordance with GAAS as required by ERISA.** Specifically, we identified 64 audits out of 279 (23 percent) that did not meet one or more elements of GAAS:

GENERAL STANDARDS -- As noted previously, the general standards cover IPA proficiency, independence, and due professional care.

Overall, we did not find any problems in the IPAs maintaining independence. Also, even without the ERISA training and experience discussed later in this report, we concluded that this did not constitute noncompliance with the proficiency requirements of GAAS.

However, we did conclude that there was a significant problem with meeting the GAAS requirement for due pr~~ofessional care~~. We found that 28 audits, or about 10 percent, did not meet the standard for due professional care. While this represents a somewhat low percentage of audits, the seriousness of the deficiencies led us to conclude that this is not acceptable.

To a large degree, the lack of compliance with the field work and reporting standards, discussed later in this section, impacted the conclusions regarding due professional care. For example, in one case, an IPA did not perform any internal control evaluations at all and did not document any substantive testing of plan transactions. In this case, there was such significant noncompliance with the field work standards that we concluded the IPA also did not use due professional care. There were a number of similar examples where noncompliance with other audit standards forced a conclusion that due professional care was not exercised.

FIELD WORK STANDARDS -- GAAS noncompliance was highest in the field work standard. The major deficiency was the lack of a proper study and evaluation of the existing internal controls as a basis for reliance thereon and for the resultant determination of the extent of the tests to which auditing procedures were to be restricted. We identified 39 (14 percent) of the 279 audits reviewed that did not contain evidence that an internal control review was performed or that sufficient testing was performed to recognize and compensate for this fact.

This lack of internal controls review is disconcerting because it is a major factor in determining the level of substantive testing necessary to form an opinion on the financial statements. Unless substantive testing is performed to make up for a lack of internal control review, the entire audit can be questioned.

This problem was encountered in a cross section of IPAs reviewed. In the 39 that did not perform an internal control review, 23 percent were from national firms and 77 percent were from local/regional firms. While the majority of the problem cases were with local/regional firms, it is clear the problem is not limited to these types of firms.

For example, a national firm performed an audit of a $15 million pension plan and stated in their report that the examination was done in accordance with GAAS. They did not, however, perform a review of the plan's internal controls. In addition, their testing was performed on extremely small samples. In testing employee contributions, a judgemental sample of only 10 of 1,475 employees (less than 1 percent) were reviewed. There was no documentation in the workpapers to explain why such a small sample was taken. Representatives of the firm responded orally that they had done this audit for many years with no problems and felt that this justified the small sample. Without an internal control evaluation, a lack of prior problems does not clearly justify restricted testing.

There were also problems in the areas of planning and evidential matter. We noted a total of 24 audits which did not meet the GAAS requirements for adequate planning. Most of the deficiencies related to the lack of an audit program or other guidance which would show the audit was planned properly.

In the area of evidential matter, we found that 26 of the 279 plans did not meet the GAAS standard. Problems noted ranged from a total lack of workpapers to show any testing, to a lack of testing in specific areas. For example, in a full scope audit of a small plan, one firm did not perform any testing of employee contributions, benefit payments, or participant account balances although they were material to the financial statements. An unqualified opinion was given on the financial statements.

In addition, there were three audits where no workpapers existed to show any testing at all. These are being referred to PWBA for appropriate action, including referral to professional organizations.

We believe that the degree of noncompliance with the field work standards should be a cause of great concern to PWBA and the AICPA. While the majority of audits did comply with GAAS, a substantial number did not. The noncompliance occurred in all GAAS areas and demonstrates that improved monitoring of audit quality is needed to raise the overall audit quality and detect substandard work.

REPORTING STANDARDS -- Reporting standards cover the content and form of reporting audit results. Of the 151 full scope audits reviewed, 16 audits (11 percent) did not comply with GAAS. Within the GAAS requirements as related to audit reporting, the major problem was in presenting information accompanying the financial statements. SAS No. 29 sets forth specific requirements for reporting this information.

We found that 14 reports with supplemental information did not identify or present the information accompanying the financial statements in accordance with SAS No. 29. These reports generally did not:

-- identify accompanying information;

-- state that it was presented for additional analysis as required by GAAS;

-- reference the fairness of accompanying information; nor

-- provide a disclaimer of opinion on the accompanying information as required by SAS No. 29.

This demonstrates the deficiencies related to the presentation of accompanying information. This area is especially important to plan participants because much of the material ERISA specifically requires is contained in the supplemental information. For example, this is where the schedules related to parties-in-interest and reportable transactions would be contained. Participants need assurances on the accompanying information, just as in the basic financial statements, in order to properly monitor plan operations.

CAUSES NEED TO BE ADDRESSED -- Deficiencies found in the IPA work can be traced to several causes. Three principal causes among these are (1) nonmonitoring of ERISA audit work by PWBA, (2) a lack of enforcement activity by PWBA, and (3) a low priority given to ERISA audit coverage.

(1) A major cause of the deficient work is the fact that ERISA audit work has never been monitored from an ERISA point of view by PWBA. PWBA has not had a review function which would monitor IPA compliance with GAAS, although such compliance is an ERISA requirement.

PWBA could begin monitoring compliance with GAAS as part of its quality review of IPA reports by expanding its review objectives to include audit quality. PWBA could then use enforcement authority provided by ERISA to upgrade the quality of their work, obtain additional audit work to comply with standards, and/or make appropriate referrals to professional organizations.

Recently, the AICPA has begun requiring member firms to obtain peer reviews. However, the AICPA still does not have any specific reviews for ERISA audits. Any peer reviews done at the firms we visited concentrated on company financial statement audits rather than ERISA plan audits. Therefore, there is no monitoring control to specifically detect substandard ERISA work. ERISA is a specialized area and we believe ERISA audits should be specifically included in peer reviews.

Establishing specific ERISA requirements within the AICPA peer reviews would elevate the priority of and attention to ERISA audits. The AICPA could provide that peer reviews specifically include ERISA work. This would help ensure that GAAS is complied with and plan participants are being properly protected.

(2) Currently, there is no enforcement activity and there is little incentive for IPAs to improve their work. Little oversight exists; enforcement is minimal and, with the exception of referrals we made to PWBA (for potential referral to State Boards of Accountancy), no previous enforcement actions have been taken against IPAs that we could identify. Overall, PWBA has not used the enforcement authority it has over plan administrators.

PWBA has the expertise to evaluate the quality of audit work and reporting. More importantly, in its capacity as acting for plan participants, it has the responsibility for assuring that ERISA requirements are complied with, including the requirements for audits that meet GAAS and financial statements that comply with GAAP.

To meet this responsibility effectively, PWBA needs to use its enforcement authority to obtain compliance and impose penalties or sanctions for noncompliance. This includes requiring plan administrators to obtain additional audit work where substandard work is found. While PWBA should continue to work with the AICPA and State Boards of Accountancy, it should also begin stricter enforcement of ERISA requirements with plan administrators.

(3) Finally, during the review and particularly our interviews with IPA firms, it was apparent that audits of employee benefit plans were not a high priority. Generally, the plan was audited only because it was required under ERISA and was done as part of the audit of the sponsor's overall financial statements. As such, it

was generally considered least important of the two audits to both the sponsor and the IPA firm.

This is reflected in much of the information we obtained from IPAs. For example, most plan audits were completed in less than 40 hours. This appears to be an extremely short time to perform a complete GAAS audit including the coverage required by ERISA. Also, some firms claimed to have charged the plan or sponsor very little or, in one instance, nothing for the audit. Certainly this would discourage spending the necessary time to perform a comprehensive audit.

ERISA-INTENDED ASSURANCES NOT PROVIDED -- As a result of these deficiencies, IPA audits do not provide the intended assurances or protections of participant rights and benefits as envisioned by Congress.

ERISA requires GAAS audits for many reasons. Conducting annual audits of plans in accordance with GAAS is intended to 1) assure that plan operations and transactions are open to inspection and will be reported to participants and beneficiaries, and 2) enforce fiduciary obligations. Fiduciary responsibility operates effectively only if fiduciaries are aware that the details of their actions will be inspected and reported to participants in sufficient detail to allow them to enforce their rights and the fiduciary's obligations.

Additionally, subjecting financial statements to GAAS audits is intended to provide participants and administrators alike with information as to the plan's financial condition, investment positions, and financial transactions significant to participant interests. Without overall compliance with GAAS, these objectives cannot be achieved. If control systems are not properly evaluated and transactions are not properly reviewed, the primary protective functions intended by ERISA are eliminated. Participants must be able to rely on the IPA who is there on their behalf to perform to minimum standards established by the profession and recognized by ERISA.

It must be kept in mind that ERISA was enacted because of congressional concern with the abuse and mismanagement of employee benefit plans. ERISA established increased reporting and disclosure requirements as a control to discourage the abuse. It is expected that Congress may continue to strengthen these controls until a satisfactory level of employee protection is provided. If PWBA or the accounting profession does not provide the protections administratively, Congress may legislate more controls.

Conclusions -- We believe that the degree of noncompliance with ERISA and GAAS requirements necessitates corrective action by PWBA. The $1.2 trillion of participant assets needs a substantial amount of protection to minimize abuse and mismanagement. The IPA role in providing this protection is critical and full compliance with ERISA is necessary.

RECOMMENDATIONS

We recommend that PWBA:

- work with the AICPA to obtain specific monitoring coverage of ERISA audits in peer reviews;
- expand its quality review procedures to include evaluations of IPA audit work to determine compliance with GAAS; and
- use its existing enforcement authority against plan administrators to obtain corrective action on deficient IPA audit work where appropriate.

PWBA'S RESPONSE

In general, PWBA agreed with the intent of these recommendations.

PWBA stated:

> Specifically, PWBA now has an Office of the Chief Accountant (OCA), one of whose primary functions is to establish effective liaison with the AICPA, the Financial Accounting Standards Board, and other professional and governmental and auditing organizations. Through that office, we are actively participating with the AICPA's Employee Benefit Plan Committee in its revision of the audit and accounting guide for Audits of Employee Benefit Plans. In addition, as part of its FY 1990 agenda, OCA will implement an aggressive quality assurance program to review the quality and content of IPA audits.
>
> Formal procedures have been implemented with the AICPA to refer instances of substandard work for appropriate disciplinary action by the AICPA and/or the relevant state licensing authorities. These procedures were put in place earlier this year and cases have been referred for action. We believe that these actions may be sufficient, particularly when viewed in conjunction with the intensive automated review of Form 5500s as part of the Department's new reporting enforcement program. Under this program, the Secretary may assess a civil penalty of up to $1,000 per day (ERISA section 502(c)(2)) against the Plan Administrator who files a deficient Form 5500. An inadequate IPA report would result in a filing

> deficiency, and subject the Plan Administrator to a substantial civil penalty. Under this mechanism, the Plan Administrator has a direct interest in obtaining adequate IPA reports.
>
> Since the procedures for referral to the AICPA have just been implemented, and DOL's reporting enforcement program is presently being implemented, we believe it prudent to review their effectiveness after an appropriate period before seeking significant new authority.

AUDITOR'S CONCLUSION

We concur with PWBA's proposed actions. We agree that PWBA should allow an appropriate period to evaluate the effectiveness of the enforcement program before seeking new authority. Therefore, we have adjusted our recommendations accordingly.

III. IPA REPORTS FOR EMPLOYEE BENEFIT PLANS DO NOT MEET ERISA OR DOL REQUIREMENTS

Our review of 279 IPA reports identified 181 (65 percent) that did not meet ERISA or DOL requirements. In these cases, IPAs did not (a) disclose that the financial statements or accompanying information did not comply with ERISA or DOL regulations, or (b) give the audit opinion required by ERISA or DOL regulations on the information which is to accompany a plan's financial statements. This occurred because some IPAs were not aware of the requirements. Additionally, there has been a lack of enforcement from PWBA and IRS when incomplete or incorrect information is submitted. Consequently, plan participants are not receiving the information or protections of full disclosure as Congress intended.

ERISA, Section 103(a), requires plan administrators to engage, on behalf of plan participants, a qualified independent public accountant to conduct annual audits. Under this section of the law and implementing DOL regulations, the accountant is required to express an opinion on the financial statements and schedules, **which must include certain disclosures specified by ERISA and DOL regulations.**

Specifically, ERISA and DOL regulations require financial statements to disclose specific information about plan operations such as the plan funding policy and changes, material lease commitments, and priorities upon plan termination. These disclosures are to alert audit report users, mainly PWBA and plan participants and beneficiaries, to potential breaches of fiduciary duties which could affect participant rights and benefits. IPAs are required by ERISA, Section 103(a)(3)(A), to give an opinion on the financial statements, which must include the following disclosures:

- statement of assets held for investment,
- schedule of party-in-interest transactions,
- schedule of loans or fixed income obligations in default,
- list of all leases in default, and
- schedule of reportable transactions as defined by ERISA and DOL regulations.

If ERISA disclosure deficiencies exist in either the financial statements or the IPA reports, PWBA can take several actions to obtain corrective action. The current remedies for deficient financial statements and IPA reports are provided in ERISA, Section 104(a)(4) and (5). According to these sections, PWBA can:

- -- reject deficient statements or reports and provide plan administrators with 45 days in which to file a satisfactory report;
- -- retain an IPA to perform an audit and charge the plan for the audit costs; or
- -- bring civil action against the plan for such relief as may be appropriate in enforcing ERISA.

In addition, PWBA can take other actions including referring deficient audit reports to appropriate professional organizations and state regulatory agencies for review and possible action.

Despite the requirements and enforcement authority, IPA reports and accompanying financial statements and schedules did not generally meet the disclosure requirements of ERISA or DOL regulations. The deficiencies and the causes are discussed in the following sections.

IPA Report Deficiencies

ERISA, Section 103(a), requires specific information to be disclosed in the financial statements and notes to the financial statements, and accompanying schedules. ERISA, Section 103(a), also requires that IPAs give an opinion on the financial statements **and the required schedules**. However, 181 (65 percent) of the 279 reports did not disclose that the financial statements and/or schedules lacked one or more ERISA-required disclosures.

For example, schedules of (a) parties-in-interest, (b) assets held for investment, and (c) reportable transactions are required to accompany the financial statements. **ERISA specifically requires that the IPA give an opinion on these schedules.** The following table shows that these schedules were not provided in a significant number of cases and this fact was not recognized in the IPA report.

PERCENTAGE OF NONCOMPLIANCE WITH ERISA DISCLOSURE REQUIREMENTS

279 PLANS

Required Schedule of:	Plans Requiring Schedule	Number without Schedule	Percent of Non-Compliance
Transactions with Parties-In-Interest	5	5	100%
Assets Held for Investment	218	84	39%
Reportable Transactions	180	34	19%

Since these reports did not contain the required schedule, the IPA could not express the opinion required by ERISA. None of the IPA reports on these financial statements disclosed the lack of ERISA-required information.

As can be seen from the table, IPAs are not disclosing the lack of required information or providing participants with the required opinion on schedules intended to provide participants with information about their plan. This represents widespread noncompliance with the ERISA reporting and disclosure requirements.

While the missing schedules, or parts of them, not recognized by the IPAs were the primary deficiency noted in the disclosure area, there were numerous other problems. For example, 17 percent of the financial statements prepared by plan administrators did not give a general description of priorities upon termination of the plan, although specifically required by ERISA.

These specific statistics and the overall noncompliance rate of 65 percent clearly show that IPAs are not meeting ERISA requirements.

Causes for Deficiencies

During the review, we discussed all deficiencies with the performing IPA office. Overall, we found (1) IPAs were not fully aware of all of the ERISA reporting and disclosure provisions, and (2) PWBA or IRS had not taken any enforcement actions to ensure compliance.

Lack of Awareness -- IPAs are not sufficiently aware of ERISA reporting requirements because a large percentage of IPAs have not had adequate training. Our sample indicated that a significant number of firms, especially smaller firms, do not provide their staff with any ERISA-related training. While it can be assumed that the firms have access to the AICPA Guide and other reading material, it is apparent that many firms, especially smaller firms, are not aware of specific ERISA disclosure requirements. Specifically, of all financial statements and schedules reported on by local and regional firms, 80 percent had at least one ERISA-required disclosure missing.

In interviewing the IPAs, it was apparent that there were wide differences in the experience, training, guidance, and resources available for ERISA audits. The circumstances ranged from a sole proprietorship who performed only one ERISA audit a year, to international firms doing hundreds of ERISA audits annually. The larger firms appeared to have more resources available for training and overall audit guidance. Some national firms had their own internal publication on ERISA audits. Generally, they also provided more training and, through volume alone, provided more ERISA-related experience and expertise.

Local and regional firms could not provide this level of resources. For example, the financial statements for one plan in the sample with assets of about $23 million, audited by a local firm, had 10 missing ERISA-required disclosures. Neither the Statement of Assets Held for Investment nor Transactions in Excess of 3 percent were included. The IPA, however, did not recognize the lack of disclosures and did not give the opinion required by ERISA. According to the firm, their training consisted of on-the-job experience only, with no ERISA-specific training. They did not use the AICPA Guide. Despite the lack of training in ERISA and the obvious lack of knowledge of disclosure requirements, the firm reported that 10 percent of their work was ERISA related.

While the larger national firms do provide more ERISA training and experience, there is still need for improvement. In our sample, 58 percent of the financial statements audited by national firms had disclosure deficiencies which were not recognized in the audit report.

The overall lack of compliance shows a lack of awareness of ERISA requirements by IPAs. This lack of awareness is primarily related to insufficient ERISA-related training. This would be an excellent area for PWBA to work with the AICPA and other professional groups to provide resources and guidance to IPA firms, especially smaller firms.

Lack of Enforcement -- In the past, PWBA has not monitored or enforced report compliance or quality. This has contributed to a continuing problem of lack of disclosures. Many IPAs in our sample expressed surprise that their reports did not comply with ERISA because for years they had done their reports the same way without comment from PWBA or IRS. They assumed the lack of action from these agencies was tacit approval of their reports.

Since PWBA has not monitored report compliance in the past, enforcement has been almost non-existent. In fact, according to PWBA, no enforcement action has ever been taken based on the monitoring of IPA report quality.

PWBA has initiated action in this area with the creation and staffing of the Office of the Chief Accountant. In addition, PWBA has been working with the IRS to improve the editing and analysis of Form 5500 and accompanying IPA reports.

Conclusions -- As a result of the lack of awareness, training, guidance and enforcement, plan participants have not received the disclosures they were due nor the resultant protection that Congress intended.

In developing the disclosure requirements in ERISA, there were numerous intentions. Primary among these was to increase plan participants' awareness of their plan administrators' actions. This was to enable plan participants to self-police their plan administrators' actions and encourage better management. However, this level of participants' control and awareness cannot be achieved unless full and complete disclosures are made.

Both the PWBA and AICPA have recently taken steps to improve the quality of IPA reports. The AICPA Guide is being revised to better reflect ERISA requirements and PWBA is providing technical input to this revision. PWBA is also developing a review plan to monitor the quality of IPA reports.

However, we believe that this effort will only partially resolve the problem. The need for providing continuing training and guidance to IPAs in ERISA work is not being addressed.

Because of the importance of benefits to pension and welfare plan participants, IPAs performing audits of employee benefit plans should also have specialized knowledge, training and oversight. ERISA audit work is highly technical and IPAs working in this area should have specialized training and adequate guidance. Because of the importance of pension and welfare benefits to each American, ERISA audits deserve this attention.

RECOMMENDATIONS

We recommend that PWBA:

-- encourage the AICPA to increase the amount of ERISA-related training and oversight (this should include specifically reviewing ERISA reports during peer reviews);

-- continue to implement the quality control reviews of IPA reports;

-- establish feedback procedures in conjunction with the IRS to inform IPAs of deficient reporting; and

-- use current provisions of ERISA as remedies for deficient IPA reports, including civil actions, when necessary.

PWBA'S RESPONSE

PWBA generally agreed with the finding and recommendations and stated:

> PWBA agrees with the OIG regarding the need for increased training for IPAs who audit employee benefit plans subject to ERISA, and we have discussed with the AICPA alternatives for improving such training. While the AICPA does not favor an ERISA Practice Section, they believe that the objectives of a separate section may be accomplished through enhanced ERISA training and a required peer-review program. Accordingly, we are considering whether legislation is needed for this purpose.
>
> In addition, we believe that the AICPA should sponsor update conferences on employee-benefit plan issues, similar to the conferences held by the AICPA in other specialized areas, such as banking and securities conferences. We have also urged the AICPA to formulate recommendations for state boards of public accountancy to revise continuing-education requirements to include specific training in the employee benefit plan area for IPAs performing plan audits.
>
> As indicated in our response to the recommendations under Category II, PWBA is actively involved in implementing a quality assurance program to review the quality of IPA reports. This program includes the authority to assess civil penalties against Plan Administrators who fail to comply with the reporting requirements of ERISA.

AUDITOR'S CONCLUSIONS

We concur with PWBA's proposed actions. In addition, we are aware of significant efforts taken with IRS to improve annual report editing and feedback to plan administrators and IPAs. We encourage PWBA to continue to refine this process.

BACKGROUND, OBJECTIVES AND SCOPE, AND SAMPLING METHODOLOGY

The Office of Inspector General has completed a quality assessment review of employee benefit plan audits performed by independent public accountants.

Background

ERISA was enacted to provide protections for participants and beneficiaries of pension and welfare benefit plans covered by the Act. **ERISA covers 4.6 million welfare plans and 915,000 pension plans that control assets of nearly $2 trillion.** The retirement security and welfare of about 66 million American workers depends upon the financial integrity of these plans.

ERISA superseded the Welfare and Pension Plans Disclosure Act of 1958 (WPPDA) as legislation to protect benefit plan assets and participants' rights. The major impetus for the enactment of ERISA was abuse and mismanagement in private pension systems which flourished under WPPDA. Employers were taking tax deductions for their contributions to pension plans, but many employees were not receiving the pensions they had been promised. Workers were often denied pensions because they failed to meet rigorous requirements concerning length of service or because their employers went out of business, leaving behind bankrupt pension funds.

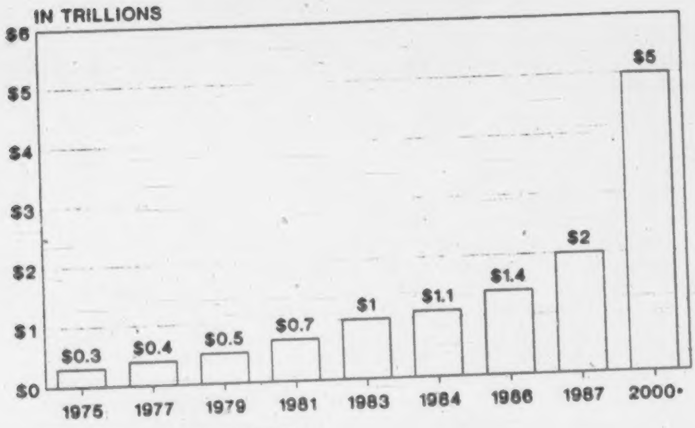
For example, a 1965 Presidential Commission reported that:

-- as few as 3 percent of the participants ever received retirement benefits from their plans; and

-- corruption, mismanagement and conflicts of interest caused the assets of many plans to be lost or misused.

As shown in the following chart, plan assets covered by the Act have grown from $293 billion in 1975 to an estimated $2 trillion today.

GROWTH OF ASSETS IN PRIVATE PLANS



• PROJECTED ON 1984-1987 AVERAGE GROWTH

With this growth has come the increased risk that plan assets will be lost or misused, as occurred under WPPDA. To minimize this risk, ERISA:

-- imposed more extensive reporting requirements on plan administrators;

-- empowered participants and Federal agencies to enjoin plan fiduciaries from violating ERISA statutes and recover losses resulting from violations;

-- established the PBGC to pay pensions owed participants by prematurely terminating defined benefit plans; and

-- charged the DOL, the Department of the Treasury, and PBGC with administration and enforcement of the Act.

IPA Audits -- As part of the annual reporting process, ERISA requires that plan administrators engage, **on behalf of all plan participants**, an IPA to annually audit those plans covering 100 or more participants. Of the 5.3 million plans, about 105,000 plans (2 percent) have 100 or more participants -- 43,000 pension plans and 62,000 welfare plans. These plans hold about $1.2 trillion (60 percent) of the nearly $2 trillion in total assets covered by ERISA statutes.

According to ERISA legislative history, the audit requirements in ERISA were intended to be conducted on behalf of the participants for their protection. The audits were intended to not only scrutinize plan transactions and operations but to make certain disclosures to plan participants so that they could self-police their plans.

Overall, these provisions were intended to curb abusive investment and managerial practices which flourished under the WPPDA.

Enforcement -- PWBA administers and enforces Title I statutes of ERISA. PWBA has about 490 employees to oversee the 5.3 million pension and welfare plans covered by ERISA. About 200 of the 490 employees are directly involved in the enforcement of ERISA statutes. These 200 investigators investigate about 1,700 of the 5.3 million plans each year.

Two other Federal agencies -- IRS and PBGC are responsible for enforcing other provisions of ERISA.

To meet the information needs of the three agencies and comply with ERISA annual reporting requirements, plan administrators are required to submit a single annual report (Form 5500 and the accompanying IPA and/or actuarial reports) to the Government. By interagency agreement, the IRS receives, edits, files, and distributes these annual reports to DOL and PBGC.

Objectives and Scope

The primary objective of our survey was to assess the protections provided by IPA audits of employee benefit plans. To accomplish this objective we:

- assessed the quality of audits being performed by IPAs and determined if their reports met both ERISA and GAAP requirements;
- determined if IPA audits of plans covered by ERISA were conducted in accordance with GAAS; and
- identified changes which would lead to better protection for plan participants and beneficiaries.

Our work included examining information contained on Form 5500, plan financial statements, the IPA report, and the IPA's workpapers.

We also interviewed representatives from the Federal Deposit Insurance Corporation (FDIC), the Federal Home Loan Bank Board (FHLBB), the Federal Reserve Bank (FRB) and the Office of Comptroller of the Currency. We supplemented these interviews with reviews and analyses of each agency's audit requirements and procedures and limited analyses of their audit results.

Additionally, we met with members of the AICPA Employee Benefit Plans Committee.

Our reviews were performed in IPA offices identified by the plan administrators. Our field work was concluded August 3, 1989.

Our review was performed in accordance with the Government Auditing Standards issued by the Comptroller General.

Sampling Methodology

The project included reviewing a sample of Form 5500s, financial statements, audit reports, and supporting audit work on plans covered by ERISA. The statistically valid sample was randomly selected using a total universe of 1,986 returns processed by the IRS through December 31, 1987. The universe was stratified by type of audit opinion and then 300 plans subject to the ERISA annual audit requirement were randomly selected. For these 300 plans we requested the financial statements, audit reports, and Forms 5500. From this initial sample, we reviewed and tested the information for 279 plans. The remaining 21 were eliminated for various reasons including (a) plan was under active investigation by PWBA and/or OIG, (b) unable to locate plan, and (c) plan was not actually required to have an audit under ERISA.

APPENDIX B

PWBA'S COMMENTS ON DRAFT REPORT

~~Curtis~~ Rev | Done

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210

RECEIVED
OFFICE OF
INSPECTOR GENERAL
89 SEP 29 AM 10: 07

September 28, 1989

MEMORANDUM FOR: J. BRIAN HYLAND
Inspector General

FROM: ANN L. COMBS
Deputy Assistant Secretary

SUBJECT: PWBA Response to Draft Report No. 09-89-004-12-001, "Changes are Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants"

This will respond to the recommendations contained in the OIG Draft Report No. 09-89-004-12-001, "Changes are Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants". Our specific response to the draft report's recommendations is contained in the **Attachment**.

The issues presented in the draft report are not new and have been the subject of significant discussion between our offices for some time. They have also been focused on at recent Congressional hearings. While we agree that the ERISA audit process should be strengthened, we firmly believe that the nation's private pension system has never been healthier. PWBA agrees, in principle, with the concerns raised in the report and is working to find solutions and, where feasible, to implement your specific recommendations.

I also must point out that the draft report fails to acknowledge the several major enforcement related initiatives which have been underway in PWBA. These initiatives were recently summarized in a September 18, 1989 letter from Deputy Secretary DeArment to the Chairman of the House Subcommittee on Employment and Housing. Specifically, PWBA has:

-- Established a new computerized database with a series of sophisticated edit checks which will examine all 5500 series forms for accuracy and completeness. This automated information system will enhance our enforcement program's ability to undertake computer targeting of employee benefit plans with the highest potential for violations. Also, under the new system, PWBA will begin receiving 5500 series data 90 days after the plan year's filing date;

-- Issued regulations implementing new civil penalties for inadequate Annual Report filings, including plan audits. Under this reporting enforcement authority, the Secretary may reject a filing and assess a civil penalty of up to $1000 per day against the Plan Administrator who files a deficient report;

-- Established the Office of the Chief Accountant in 1988 to work with the accounting profession to strengthen professional standards relating to employee benefit plan audits. This office has already begun to work closely with the AICPA both to improve the compliance of audits and reports with generally accepted auditing standards (GAAS) and ERISA through the revision of the AICPA's audit guide and to expand continuing professional education requirements. A process has been initiated for referring for discipline accountants who perform substandard work; and

-- Implemented revisions to the questions on the Form 5500 series for the 1988 plan year to gather additional data on service providers to plans, including accountants, and indicate the reasons for a qualified accountant's opinion.

In addition, the Department has taken or is taking a number of other actions to enhance the Department's ERISA enforcement. First, the Secretary has directed the Department to undertake a comprehensive review of all enforcement responsibilities, with particular focus on criminal enforcement efforts. Second, the Secretary's ERISA Advisory Council has established a task force to review the OIG's findings. Third, we are reviewing the need for additional resources for ERISA enforcement. Fourth, we are exploring other means to promote private enforcement efforts under ERISA. ERISA provides participants and beneficiaries with significant private enforcement rights, but in many cases there may be insufficient incentives for potential plaintiffs to bring such actions. We are considering ways to address this problem.

We look forward to working with your office in resolving outstanding issues and concerns addressed in this report. If you have any questions, please feel free to have your staff contact Ms. Susan Ugelow at 523-8951.

Attachment

Attachment

PWBA RESPONSE TO THE OIG'S DRAFT REPORT "CHANGES ARE NEEDED IN THE ERISA AUDIT PROCESS TO INCREASE PROTECTIONS FOR EMPLOYEE BENEFIT PLAN PARTICIPANTS"

In its draft report entitled, "Changes are Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants," the OIG made 14 recommendations to make the function of the independent public accountants (IPA) more effective in protecting the rights and benefits of participants and beneficiaries of employee benefit plans and to improve the quality of ERISA audits and filings.

We will respond to the recommendations by category rather than individually, since the OIG grouped these recommendations into three major categories.

Category I

DOL REQUIREMENTS FOR BENEFIT PLAN AUDITS NEED CHANGES TO PROVIDE STRONGER PROTECTIONS FOR PARTICIPANTS AND THEIR BENEFICIARIES

OIG Recommendations

PWBA should:

1. propose changes to ERISA to eliminate the provision for restricting the scope of plan audits;
2. work with banking and similar regulatory agencies to determine how annual audit coverage can be provided to employee plan assets held in trust;
3. obtain coverage of ERISA compliance in IPA audits by working with the AICPA on its revision to the audit guide or, if necessary, through regulatory change;
4. require plans to establish external parties to oversee IPA audits on behalf of participants; and
5. require these external parties to report known ERISA violations directly to PWBA for corrective action.

PWBA Response

Limited-Scope Audits

PWBA believes that it may be appropriate to eliminate the limited-scope audit exemption, recognizing that such a change may result in an increase in plan audit costs of 10 to 30 percent. A rough estimate of such increased costs has been provided by the AICPA. We recognize that a high percentage of plans utilize the exception, that the regulatory climate for banks and insurance companies is different (and often less reliable) than that which existed when ERISA was enacted in 1974, and that limited-scope audits conducted under the current rules raise several of the concerns included in the OIG's draft report. It may be necessary, however, to undertake additional empirical study to determine whether the limited scope audit exception should be eliminated.

One potential way to achieve more comprehensive audits, while keeping increased plan audit costs to a minimum, is to use the "single-audit approach." Under this method, the plan's IPA would obtain a special-purpose report from the bank's or insurance company's independent auditor. This report would provide assurances that the necessary procedures and review of the internal control structure of the bank or insurance company had been performed. Those assurances, when coupled with the other auditing procedures performed by the plan's IPA on transaction information, should enable the IPA to render an unqualified opinion on all assets listed on the plan's financial statements. We are working with the AICPA banking and insurance regulatory agencies to determine the feasibility of this approach.

Compliance Testing

In each of its reports, the OIG has recommended that ERISA be amended to require IPAs to test for compliance with the law and regulations, in addition to performing their traditional financial-statement audit function. The OIG reports have not, however, indicated the extent of such testing deemed necessary, nor any estimates of its cost -- which would, directly or indirectly, be borne by plan participants and beneficiaries.

It is important to note that the OIG is recommending a major change in government regulatory policy, i.e., shifting some of the responsibility and cost for determining ERISA compliance from the government to the private sector. Such major increases in the cost of pension administration might have serious effects on the willingness of employers to provide pensions for their workers.

Under existing law. the IPA audit is to be conducted in accordance with generally accepted auditing standards (GAAS). GAAS does not require compliance testing or reporting on compliance with laws and regulations. In auditing the financial statements of an employee benefit plan, the IPA is concerned only with whether the statements fairly present the financial condition of the plan -- not whether the plan complies with the law and regulations, unless any noncompliance "materially" affects the financial statements. Thus, representatives of the American Institute of Certified Public Accountants (AICPA) have advised us that they believe IPAs must, as part of their audit, satisfy themselves that the subject plan has adequate internal controls and procedures in place to permit the plan administrator to comply with legal requirements. But IPAs are not required to test for compliance or to ensure the reporting on Form 5500 of financially "immaterial" illegal transactions.

The range of possible compliance audit requirements is as broad as ERISA is complex. For example, should IPAs be required to test for all possible violations of ERISA irrespective of dollar value, subject matter, or other criteria? Should testing be required for all possible prohibited transactions, including those involving remote parties-in-interest or those which have a positive investment return? Resolution of these difficult issues necessarily involves a careful balancing of potential costs against potential additional safeguards to plan participants and beneficiaries who, in one way or another, will pay the auditing bill. Accordingly, we believe that more analysis must be devoted to this issue before we can definitively answer these questions.

During the coming six months, we will analyze these questions and seek to design a compliance testing program. We will invite the Inspector General to join us in this task, which will also involve other government agencies and the AICPA. Our target date for completing this work is March 15, 1990.

Direct Reporting

In this draft report, as well as in prior reports, the OIG has consistently recommended that PWBA require IPAs to report ERISA violations directly to the Department. The specific recommendations have differed from report to report, but their basic thrust remains the same. While we are not convinced that such a dramatic change in the relationship between accountants and clients is warranted (particularly in light of accountant-client privileges where applicable), we do believe that some changes should be considered, such as requiring the IPA to sign Form 5500 and related schedules that are the subject of his audit. Currently, only the Plan Administrator signs the Form 5500. Clearly, the resolution of the outstanding issues relating to the scope of the IPA's audit will have a direct bearing on the final outcome of this recommendation. The more compliance-oriented the IPA work, the more justification there would be to report items of non-compliance to DOL. In any case, we strongly believe that, to be useful, any such direct reporting must be made within the framework of the annual report. Accordingly, as we work to develop a proposal on the scope of IPA audits, we will include appropriate changes in IPA reporting to DOL either directly or through the establishment of audit committees.

Category II

IPA AUDITS OF PLANS COVERED BY ERISA NEED IMPROVEMENT TO CONSISTENTLY COMPLY WITH GAAS AS REQUIRED BY ERISA

OIG Recommendations

PWBA should:

6. work with the AICPA to establish specific monitoring controls over ERISA work;

7. expand its quality control procedures to include reviews and evaluations of IPA audit work to determine compliance with GAAS;

8. use its existing enforcement authority against plan administrators to obtain corrective action by professional organizations on deficient IPA audit work where appropriate; and

9. obtain additional legislative authority to penalize and/or sanction IPAs directly for substandard work.

PWBA Response

In general, PWBA agrees with the intent of these recommendations.

Specifically, PWBA now has an Office of the Chief Accountant (OCA), one of whose primary functions is to establish effective liaison with the AICPA, the Financial Accounting Standards Board (FASB), and other professional and governmental and auditing organizations. Through that office, we are actively participating with the AICPA's Employee Benefit Plan Committee in its revision of the audit and accounting guide for Audits of Employee Benefit Plans. In addition, as part of its FY 1990 agenda, OCA will implement an aggressive quality assurance program to review the quality and content of IPA audits.

Formal procedures have been implemented with the AICPA to refer instances of substandard work for appropriate disciplinary action by the AICPA and/or the relevant state licensing authorities. These procedures were put in place earlier this year and cases have been referred for action. We believe that these actions may be sufficient, particularly when viewed in conjunction with the intensive automated review of Form 5500s as part of the

Department's new reporting enforcement program. Under this program, the Secretary may assess a civil penalty of up to $1,000 per day (ERISA section 502(c)(2)) against the Plan Administrator who files a deficient Form 5500. An inadequate IPA report would result in a filing deficiency, and subject the Plan Administrator to a substantial civil penalty. Under this mechanism, the Plan Administrator has a direct interest in obtaining adequate IPA reports.

Since the procedures for referral to the AICPA have just been implemented, and DOL's reporting enforcement program is presently being implemented, we believe it prudent to review their effectiveness after an appropriate period before seeking significant new authority.

Category III

IPA PREPARED REPORTS FOR EMPLOYEE BENEFIT PLANS DO NOT MEET ERISA DISCLOSURE REQUIREMENTS

OIG Recommendations

PWBA should:

10. encourage the AICPA to increase the availability of ERISA related training and oversight. This should include specifically reviewing ERISA reports during peer reviews;

11. continue to implement the quality control reviews of IPA reports;

12. establish feedback procedures in conjunction with the IRS to inform IPAs of deficient reporting;

13. use current provisions of ERISA as remedies for deficient IPA reports, including civil actions, when necessary; and

14. obtain additional legislative authority to enforce ERISA requirements directly with IPAs.

PWBA Response

PWBA agrees with the OIG regarding the need for increased training for IPAs who audit employee benefit plans subject to ERISA, and we have discussed with the AICPA alternatives for improving such training. While the AICPA does not favor an ERISA Practice Section, they believe that the objectives of a separate section may be accomplished through enhanced ERISA training and a required peer-review program. Accordingly, we are considering whether legislation is needed for this purpose.

In addition, we believe that the AICPA should sponsor update conferences on employee-benefit plan issues, similar to the conferences held by the AICPA in other specialized areas, such as banking and securities conferences. We have also urged the AICPA to formulate recommendations for state boards of public accountancy to revise continuing-education requirements to include specific training in the employee benefit plan area for IPAs performing plan audits.

As indicated in our response to the recommendations under Category II, PWBA is actively involved in implementing a quality assurance program to review the quality of IPA reports. This program includes the authority to assess civil penalties against Plan Administrators who fail to comply with the reporting requirements of ERISA.

APPENDIX 2

Department of the Treasury
Internal Revenue Service
Department of Labor
Pension and Welfare Benefits Administration
Pension Benefit Guaranty Corporation

(With 100 or more participants)

This form is required to be filed under sections 104 and 4065 of the Employee Retirement Income Security Act of 1974 and sections 6039D, 6057(b), and 6058(a) of the Internal Revenue Code, referred to as the Code.

▶ For Paperwork Reduction Act Notice, see page 1 of the Instructions.

1988

This form is open to public inspection.

For the calendar plan year 1988 or fiscal plan year beginning 6-1-88, 1988, and ending 12-31, 1988.

If your plan year changed since the last return/report filed, check this box ▶ ☐

Type or print in ink all entries on the form, schedules, and attachments. If an item does not apply, enter "N/A." File the originals.

If (i) through (iii) do not apply to this year's return/report, leave the boxes unmarked. This return/report is:
(i) ☒ the first return/report filed for the plan; (ii) ☐ an amended return/report; or (iii) ☐ the final return/report filed for the plan.

▶ Welfare benefit plans and fringe benefit plans need only complete certain items—see the instructions "What To File."
▶ If you have been granted an extension of time to file this form, you must attach a copy of the approved extension to this form.

Use IRS label. Otherwise, please print or type.

1a Name of plan sponsor (employer if for a single-employer plan): Summit Insurance Plan Trust
Address (number and street): 1202 Rees Street, P.O. Box 360
City or town, state, and ZIP code: Breaux Bridge LA 70517

1b Employer identification number: 72 1059059
1c Telephone number of sponsor: (318) 845-5044
1d Business code number: 8999
1e CUSIP issuer number:

2a Name of plan administrator (if same as plan sponsor, enter "Same"): Group Programs, Inc
Address (number and street): P.O. Box 1210
City or town, state, and ZIP code: Breaux Bridge, LA 70517

2b Administrator's employer identification no.: 72 1045988
2c Telephone number of administrator: (318) 845-5044

3 Are the name, address, and employer identification number (EIN) of the plan sponsor and/or plan administrator the same as they appeared on the last return/report filed for this plan? ☐ Yes ☐ No. If "No," enter the information from the last return/report in a and/or b, and complete c. N/A
a Sponsor ▶ .... EIN .... Plan number ....
b Administrator ▶ .... EIN ....
c If a indicates a change in the sponsor's name and EIN, is this a change in sponsorship only? (See specific instructions for definition of sponsorship.) ☐ Yes ☐ No

4 Check the appropriate box to indicate the type of plan entity (check only one box):
a ☐ Single-employer plan
b ☐ Plan of controlled group of corporations or common control employers
c ☐ Multiemployer plan
d ☐ Multiple-employer-collectively-bargained plan
e ☒ Multiple-employer plan (other)
f ☐ Group insurance arrangement (of welfare plans)

5a (i) Name of plan ▶ Summit Insurance Plan Trust
(ii) ☐ Check if name of plan changed since last return/report
5b Effective date of plan ▶ 6-1-88
5c Enter three-digit plan number ▶ 5 0 1

6a ☐ Welfare benefit plan (plan numbers 501 through 999) must check applicable items (A) through (P) and 6c.
(i) ☐ Type
(A) ☒ Health (other than dental or vision)
(B) ☒ Life insurance
(C) ☐ Supplemental unemployment
(D) ☒ Dental
(E) ☐ Vision
(F) ☐ Temporary disability (accident & sickness)
(G) ☐ Prepaid legal
(H) ☐ Long-term disability
(I) ☐ Severance pay
(J) ☐ Apprenticeship & training
(K) ☐ Scholarship (funded)
(L) ☐ Death benefits other than life insurance
(M) ☐ Code section 120 (group legal services plan)
(N) ☐ Code section 125 (cafeteria plan)
(O) ☐ Code section 127 (educational assistance program)
(P) ☐ Other (specify) ▶ ....
(ii) If you checked (M), (N), or (O), check if plan is: ☐ funded or ☐ unfunded.

6b ☐ Pension benefit plan (plan numbers 001 through 500) must check applicable items in (i) through (vii) and answer 6c through 6f.
(i) ☐ Defined benefit plan
(ii) ☐ Defined contribution plan—(indicate type of defined contribution): (A) ☐ Profit-sharing (B) ☐ Stock bonus (C) ☐ Target benefit (D) ☐ Other money purchase (E) ☐ Other (specify) ▶ ....
(iii) ☐ Defined benefit plan with benefits based partly on balance of separate account of participant (Code section 414(k))
(iv) ☐ Annuity arrangement of certain exempt organizations (Code section 403(b)(1))
(v) ☐ Custodial account for regulated investment company stock (Code section 403(b)(7))
(vi) ☐ Pension plan utilizing individual retirement accounts or annuities (described in Code section 408) as the sole funding vehicle for providing benefits
(vii) ☐ Other (specify) ▶

▶ Caution: A penalty for the late or incomplete filing of this return/report will be assessed unless reasonable cause is established.

Under penalties of perjury and other penalties set forth in the instructions, I declare that I have examined this return/report, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Date ▶ 8-30-89 Signature of employer/plan sponsor ▶ Patrick [illegible]
Date ▶ Signature of plan administrator ▶

Form 5500 (1988)

3/13/89

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5500.1

Summit Insurance Plan Trust [illegible]

6c Other plan features: *(i)* ☐ ESOP *(ii)* ☐ Leveraged ESOP *(iii)* ☐ Participant-directed account plan
(iv) ☐ Pension plan maintained outside the United States *(v)* ☐ Master trust (see instructions)
(vi) ☐ 103-12 investment entity (see instructions) *(vii)* ☐ Common/collective trust *(viii)* ☐ Pooled separate account

d Single-employer plans enter the tax year end of the employer in which this plan year ends ▶ Month .... Day .... Year ....
e Is the employer a member of an affiliated service group?
f Does this plan contain a cash or deferred arrangement described in Code section 401(k)?

	Yes	No
		X
		X

7 Number of participants as of the end of the plan year (welfare plans complete only a(iv), b, c, and d):
a Active participants: *(i)* Number fully vested
(ii) Number partially vested
(iii) Number nonvested
(iv) Total
b Retired or separated participants receiving benefits
c Retired or separated participants entitled to future benefits
d Subtotal (add a(iv), b, and c)
e Deceased participants whose beneficiaries are receiving or are entitled to receive benefits
f Total (add d and e)
g *(i)* Was any participant(s) separated from service with a deferred vested benefit for which a Schedule SSA (Form 5500) is required to be attached to this form?
(ii) If "Yes," enter the number of separated participants required to be reported ▶

a(i)	
(ii)	
(iii)	
(iv)	2219
b	
c	
d	2219
e	
f	2219

8a Were any plan amendments adopted during the plan year?
b Did any amendment result in the retroactive reduction of accrued benefits for any participant?
c Enter the date the most recent amendment was adopted ▶ Month N/A Day .... Year ....
d If a is "Yes," did any amendment change the information contained in the latest summary plan descriptions or summary description of modifications available at the time of the amendment?
e If d is "Yes," has a summary plan description or summary description of modifications that reflects the plan amendments referred to in d been furnished to participants and filed with the Department of Labor?

9a Was this plan terminated during this plan year or any prior plan year? If "Yes," enter the year ▶
b Were all plan assets either distributed to participants or beneficiaries, transferred to another plan, or brought under the control of PBGC?
c Was a resolution to terminate this plan adopted during this plan year or any prior plan year?
d If a or c is "Yes," have you received a favorable determination letter from IRS for the termination?
e If d is "No," has a determination letter been requested from IRS?
f If a or c is "Yes," have participants and beneficiaries been notified of the termination or the proposed termination?
g If a is "Yes" and the plan is covered by PBGC, is the plan continuing to file a PBGC Form 1 and pay premiums until the end of the plan year in which assets are distributed or brought under the control of PBGC?
h During this plan year, did any trust assets revert to the employer for which the Code section 4980 excise tax is due?
i If h is "Yes," enter the amount of tax paid with your Form 5330 ▶

	Yes	No
g(i)		✓
8a		✓
b		✓
d	N/A	
e	N/A	
9a		✓
b		✓
c		✓
d	N/A	
e	N/A	
f	N/A	
g	N/A	
h		✓

10a In this plan year, was this plan merged or consolidated into another plan(s), or were assets or liabilities transferred to another plan(s)? ☐ Yes ☑ No
If "Yes," identify other plan(s)
b Name of plan(s) ▶ **c** Employer identification number(s) **d** Plan number(s)
e Has Form 5310 been filed? ☐ Yes ☐ No

11 Enter the plan funding arrangement code (see instructions)
6 - Employer & Employee Contribution

12 Enter the plan benefit arrangement code (see instructions)
5

13a Is this a plan established or maintained pursuant to one or more collective bargaining agreements?
b If a is "Yes," enter the appropriate six-digit LM number(s) of the sponsoring labor organization(s) (see instructions):
▶ *(i)* *(ii)* *(iii)*

	Yes	No
13a		✓

14 If any benefits are provided by an insurance company, insurance service, or similar organization, enter the number of Schedules A (Form 5500), Insurance Information, that are attached. If none, enter "-0-." ▶ 2

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Summit Insurance [illegible]

WELFARE PLANS DO NOT COMPLETE ITEMS 15 THROUGH 27. GO TO ITEM 28

Items 15 thru 27 → N/A

			Yes	No
15a	If this is a defined benefit plan, is it subject to the minimum funding standards for this plan year? If "Yes," attach Schedule B (Form 5500).	15a		
b	If this is a defined contribution plan, i.e., money purchase or target benefit, is it subject to the minimum funding standards? (If a waiver was granted, see instructions.)	b		

If "Yes," complete *(i)*, *(ii)*, and *(iii)* below:

(i) Amount of employer contribution required for the plan year under Code section 412 . . . b(i) $

(ii) Amount of contribution paid by the employer for the plan year . . . b(ii) $

Enter date of last payment by employer ▶ Month ______ Day ______ Year ______

(iii) If *(i)* is greater than *(ii)*, subtract *(ii)* from *(i)* and enter the funding deficiency here; otherwise, enter zero. (If you have a funding deficiency, file Form 5330.) . . . b(iii) $

			Yes	No
16	Has the plan been top-heavy at any time beginning with the 1984 plan year?	16		
17	Has the plan accepted any transfers or rollovers with respect to a participant who had attained age 70½?	17		
18a	If the plan distributed any annuity contracts this year, did these contracts contain a requirement that the spouse consent before any distributions under the contract are made in a form other than a qualified joint and survivor annuity?	18a		
b	Did the plan make distributions to participants or spouses in a form other than a qualified joint and survivor annuity (a life annuity if a single person) or qualified preretirement survivor annuity (exclude deferred annuity contracts)?	b		
c	Did the plan make distributions or loans to married participants and beneficiaries without the required consent of the participant's spouse?	c		
d	Upon plan amendment or termination, do the accrued benefits of every participant include the subsidized benefits that the participant may become entitled to receive subsequent to the plan amendment or termination?	d		
19	Were the spousal consent requirements for distributions under Code section 417(e) complied with?	19		
20	Have any contributions been made or benefits accrued in excess of the Code section 415 limits, as amended by the Tax Reform Act of 1986?	20		
21	Has the plan made the required distributions in 1988 under Code section 401(a)(9)?	21		
22a	Does the plan satisfy the percentage test of Code section 410(b)(1)(A)? If a is "Yes," complete b through i. If "No," complete only b and c below and see specific instructions.	22a		

			Number
b *(i)*	Number of employees who are aggregated with employees of the employer as a result of the employer being aggregated with any employer covered by this plan under Code section 414(b), (c), or (m)	b(i)	
(ii)	Number of individuals who performed services as leased employees under Code section 414(n) including leased employees of employers in *(i)*	b(ii)	
c	Total number of employees (including any employees aggregated in b)	c	
d	Number of employees excluded under the plan because of *(i)* minimum age or years of service, *(ii)* employees on whose behalf retirement benefits were the subject of collective bargaining, or *(iii)* nonresident aliens who receive no earned income from United States sources	d	
e	Total number of employees not excluded (subtract d from c)	e	
f	Employees ineligible (specify reason) ▶	f	
g	Employees eligible to participate (subtract f from e)	g	
h	Employees eligible but not participating	h	
i	Employees participating (subtract h from g)	i	

			Yes	No
23a	Is it intended that this plan qualify under Code section 401(a)? If "Yes," complete b and c.	23a		
b	Enter the date of the most recent IRS determination letter . . . Month ______ Year ______			
c	Is a determination letter request pending with IRS?	c		
24a	If this is a plan with Employee Stock Ownership features, was a current appraisal of the value of the stock made immediately before any contribution of stock or the purchase of the stock by the trust for the plan year covered by this return/report?	24a		
b	If a is "Yes," was the appraisal made by an unrelated third party?	b		
25	Is this plan integrated with social security or railroad retirement?	25		
26	Does the employer/sponsor listed in 1a of this form maintain other qualified pension benefit plans? If "Yes," enter the total number of plans, including this plan ▶	26		

27 If this plan is an adoption of a master, prototype, or uniform plan, indicate which type by checking the appropriate box: a ☐ Master b ☐ Prototype c ☐ Uniform

Summit Insurance Plan Trust 1 [illegible]

rm 5500 (1988)

		Yes	No
8a Did any person who rendered services to the plan receive directly or indirectly $5,000 or more in compensation from the plan during the plan year (except for employees of the plan who were paid less than $1,000 in each month)? If "Yes," complete Part I of Schedule C (Form 5500).	28a	✓	
b Did the plan have any trustees who must be listed in Part II of Schedule C (Form 5500)?	b	✓	
c Has there been a termination in the appointment of any person listed in d below?	c		✓
d If c is "Yes," check the appropriate box(es), answer e and f, and complete Part III of Schedule C (Form 5500): (i) ☐ Accountant (ii) ☐ Enrolled actuary (iii) ☐ Insurance carrier (iv) ☐ Custodian (v) ☐ Administrator (vi) ☐ Investment manager (vii) ☐ Trustee			
e Have there been any outstanding material disputes or matters of disagreement concerning the above termination?	e		N/A
f If an accountant or enrolled actuary has been terminated during the plan year, has the terminated accountant/actuary been provided a copy of the explanation required by Part III of Schedule C (Form 5500) with a notice advising them of their opportunity to submit comments on the explanation directly to DOL?	f		N/A
g Enter the number of Schedules C (Form 5500) that are attached. If none, enter -0- ▶ 1			
9a Is this plan exempt from the requirement to engage an independent qualified public accountant?	29a	✓	
b If a is "No," attach the accountant's opinion to this return/report and check the appropriate box. This opinion is: (i) ☐ Unqualified (ii) ☐ Qualified/disclaimer per Department of Labor Regulations 29 CFR 2520.103-8 and/or 2520.103-12(d) (iii) ☐ Qualified/disclaimer other (iv) ☐ Adverse (v) ☐ Other (explain)			
c If a is "No," do the financial statements or notes to the financial statements attached to this return/report disclose (i) a loss contingency indicating that assets are impaired or liability incurred; (ii) significant real estate or other transactions in which the plan and (A) the sponsor, (B) plan administrator, (C) the employer(s), or (D) the employee organization(s) are jointly involved; (iii) that the plan has participated in any related party transactions; or, (iv) any unusual or infrequent events or transactions occurring subsequent to the plan year-end that might significantly affect the usefulness of the financial statements in assessing the plan's present or future ability to pay benefits?	c	N/A	
d If c is "Yes," provide the total amount involved in such disclosure ▶			
0 If 29a is "No," during the plan year: N/A			
a Did the plan have assets held for investment?	30a	N/A	
b Were any loans by the plan or fixed income obligations due the plan in default as of the close of the plan year or classified during the year as uncollectible?	b		
c Were any leases to which the plan was a party in default or classified during the year as uncollectible?	c		
d Were any plan transactions or series of transactions in excess of 5% of the current value of plan assets?	d		
e Do the notes to the financial statements accompanying the accountant's opinion disclose any nonexempt transactions with parties-in-interest?	e		
f Did the plan engage in any nonexempt transactions with parties-in-interest not reported in e?	f		
g Did the plan hold qualifying employer securities that are not publicly traded?	g		
h Did the plan purchase or receive any nonpublicly traded securities that were not appraised in writing by an unrelated third party within 3 months prior to their receipt?	h		
i Did any person manage plan assets who had a financial interest worth more than 10% in any party providing services to the plan or receive anything of value from any party providing services to the plan? If a, b, c, d, e, or f is checked "Yes," schedules of those items in the format set forth in the instructions are required to be attached to this return/report.	i		
1 Did the plan acquire individual whole life insurance contracts during the plan year?	31		✓
2 During the plan year: a (i) Was this plan covered by a fidelity bond?	32a	✓	
(ii) If (i) is "Yes," enter amount of bond ▶ $500,000			
b (i) Was there any loss to the plan, whether or not reimbursed, caused by fraud or dishonesty?	b		✓
(ii) If (i) is "Yes," enter amount of loss ▶			

,3a Is the plan covered under the Pension Benefit Guaranty Corporation termination insurance program?

☐ Yes ☐ No ☐ Not determined N/A

b If a is "Yes" or "Not determined," enter the employer identification number and the plan number used to identify it.

Employer identification number ▶

Plan number ▶

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Form 5500 (1988) Summit Insurance Plan Trust 72-1059059 Page 5

34 **Current value of plan assets and liabilities at the beginning and end of the plan year. Combine the value of plan assets held in more than one trust. Allocate the value of the plan's interest in a commingled trust containing the assets of more than one plan on a line-by-line basis unless the trust meets one of the specific exceptions described in the instructions. Do not enter the value of that portion of an insurance contract which guarantees, during this plan year, to pay a specific dollar benefit at a future date. Round off amounts to the nearest dollar. Plans with no assets at the beginning and the end of the plan year, enter zero on line 34f.**

N/A

Assets		(a) Beginning of year	(b) End of Year
a Total noninterest-bearing cash	a		
b Receivables (net):			
(i) Employer contributions	b(i)		
(ii) Participant contributions	(ii)		
(iii) Income	(iii)		
(iv) Other	(iv)		
(v) Total	(v)		
c General investments:			
(i) Interest-bearing cash (including money market funds)	c(i)		
(ii) Certificates of deposit	(ii)		
(iii) U.S. Government securities	(iii)		
(iv) Corporate debt instruments	(iv)		
(v) Corporate stocks:			
(A) Preferred	(v)(A)		
(B) Common	(B)		
(vi) Partnership/joint venture interests	(vi)		
(vii) Real estate:			
(A) Income-producing	(vii)(A)		
(B) Nonincome-producing	(B)		
(viii) Loans (other than to participants) secured by mortgages:			
(A) Residential	(viii)(A)		
(B) Commercial	(B)		
(ix) Loans to participants:			
(A) Mortgages	(ix)(A)		
(B) Other	(B)		
(x) Other loans	(x)		
(xi) Value of interest in certain investment arrangements (see instructions)	(xi)		
(xii) Value of funds held in insurance company general account (unallocated contracts)	(xii)		
(xiii) Other	(xiii)		
(xiv) Total	(xiv)		
d Employer-related investments:			
(i) Employer securities	d(i)		
(ii) Employer real property	(ii)		
e Buildings and other property used in plan operation	e		
f Total assets	f		
Liabilities			
g Benefit claims payable	g		
h Operating payables	h		
i Acquisition indebtedness	i		
j Other liabilities	j		
k Total liabilities	k		
Net Assets			
l Line f minus line k	l		

Form 5500 (1988) Summit Insurance Plan Trust 72 - 1059059 Page 6

35 Plan income, expenses, and changes in net assets for the plan year. N/A

Include all income and expenses of the plan, including any trust(s) or separately maintained fund(s), and any payments/receipts to/from insurance carriers. Round off amounts to the nearest dollar.

Income		(a) Amount	(b) Total
a Contributions:			
(i) Received or receivable from:			
(A) Employers	a(i)(A)		
(B) Participants	(B)		
(C) Others	(C)		
(ii) Noncash contributions	(ii)		
b Earnings on investments:			
(i) Interest:			
(A) Interest-bearing cash (including money market funds)	b(i)(A)		
(B) Certificates of deposit	(B)		
(C) U.S. Government securities	(C)		
(D) Corporate debt instruments	(D)		
(E) Mortgage loans	(E)		
(F) Other loans	(F)		
(G) Other	(G)		
(ii) Dividends:			
(A) Preferred stock	b(ii)(A)		
(B) Common stock	(B)		
(iii) Rents	(iii)		
(iv) Net gain (loss) on sale of assets:			
(A) Aggregate proceeds	b(iv)(A)		
(B) Aggregate costs	(B)		
(v) Unrealized appreciation (depreciation) of assets	(v)		
(vi) Net investment gain (loss) from certain investment arrangements—see instructions	(vi)		
c Other income	c		
d Total income (add a, b, and c)	d		
Expenses			
e Benefit payment and payments to provide benefits:			
(i) Directly to participants or beneficiaries	e(i)		
(ii) To insurance carriers for the provision of benefits	(ii)		
(iii) Other	(iii)		
f Interest expense	f		
g Administrative expenses:			
(i) Salaries and allowances	g(i)		
(ii) Accounting fees	(ii)		
(iii) Actuarial fees	(iii)		
(iv) Contract administrator fees	(iv)		
(v) Investment advisory and management fees	(v)		
(vi) Legal fees	(vi)		
(vii) Valuation/appraisal fees	(vii)		
(viii) Trustees fees/expenses (including travel, seminars, meetings, etc.)	(viii)		
(ix) Other	(ix)		
h Total expenses (add e, f, and g)	h		
i Net income (loss) (d minus h)	i		
j Transfers to (from) the plan (see instructions)	j		
k Net assets at beginning of year (line 34l, column (a))	k		
l Net assets at end of year (line 34l, column (b))	l		

	Yes	No
36 Did any employer sponsoring the plan pay any of the administrative expenses of the plan that were not reported in 35g?		

(Form 5500)
Department of the Treasury
Internal Revenue Service
Department of Labor
Pension and Welfare Benefits Administration
Pension Benefit Guaranty Corporation

This schedule is required to be filed under section 104 of the Employee Retirement Income Security Act of 1974.

▶ File as an Attachment to Forms 5500, 5500-C, or 5500-R.

▶ Insurance companies are required to provide this information as per ERISA section 103(a)(2).

1988

This Form Is Open to Public Inspection

For calendar year 1988 or fiscal plan year beginning 6-1, 1988 and ending 12-31, 1988.

▶ Part I must be completed for all plans required to file this schedule.
▶ Part II must be completed for all insured pension plans.
▶ Part III must be completed for all insured welfare plans.

▶ Enter master trust or 103-12 IE name in place of "sponsor" and specify investment account or 103-12 IE in place of "plan" if filing with DOL for a master trust or 103-12 IE.

Name of plan sponsor as shown on line 1a of Form 5500, 5500-C, or 5500-R: Summit Insurance Plan Trust

Employer identification number: 72-1059059

Name of plan: Same

Enter three-digit plan number ▶ 501

Part I Summary of All Insurance Contracts Included in Parts II and III

Group all contracts in the same manner as in Parts II and III.

1 Check appropriate box: a ☑ Welfare plan b ☐ Pension plan c ☐ Combination pension and welfare plan

2 Coverage:

(a) Name of insurance carrier	(b) Contract or identification number	(c) Approximate number of persons covered at end of policy or contract year	Policy or contract year (d) From	(e) To
United National Ins Co. of Philadelphia	501	2219	6-1-88	12-31-88

3 Insurance fees and commissions paid to agents and brokers:

(a) Contract or identification number	(b) Name and address of the agents or brokers to whom commissions or fees were paid	(c) Amount of commissions paid	(d) Fees paid: Amount	(d) Fees paid: Purpose
	Group Programs, Inc P.O. Box 1210 Breaux Bridge,	8906.25		
Total				

4 Premiums due and unpaid at end of the plan year ▶ $ 0 : Contract or identification number ▶

Part II Insured Pension Plans

Provide information for each contract on a separate Part II. Where individual contracts are provided, the entire group of such individual contracts with each carrier may be treated as a unit for purposes of this report.

▶ Contract or identification number ▶ N/A

5 Contracts with allocated funds, for example, individual policies or group deferred annuity contracts:
- a State the basis of premium rates ▶
- b Total premiums paid to carrier
- c If the carrier, service, or other organization incurred any specific costs in connection with the acquisition or retention of the contract or policy, other than reported in 3 above, enter amount
  Specify nature of costs ▶

6 Contracts with unallocated funds, for example, deposit administration or immediate participation guarantee contracts. Do not include portions of these contracts maintained in separate accounts:
- a Balance at the end of the previous policy year
- b Additions: (i) Contributions deposited during year
  - (ii) Dividends and credits
  - (iii) Interest credited during the year
  - (iv) Transferred from separate account
  - (v) Other (specify) ▶
  - (vi) Total additions
- c Total of balance and additions, add a and b(vi)
- d Deductions:
  - (i) Disbursed from fund to pay benefits or purchase annuities during year
  - (ii) Administration charge made by carrier
  - (iii) Transferred to separate account
  - (iv) Other (specify) ▶
  - (v) Total deductions
- e Balance at end of current policy year, subtract d(v) from c

7 Separate accounts: Current value of plan's interest in separate accounts at year end

For Paperwork Reduction Act Notice, see page 1 of the Instructions for Form 5500 or 5500-C.

Schedule A (Form 5500) 1988

Schedule A (Form 5500) 1988 Summit Insurance Plan Trust 12-1059057

Part III **Insured Welfare Plans**

Provide information for each contract on a separate Part III. If more than one contract covers the same group of employees of the same employer(s) or members of the same employee organization(s), the information may be combined for reporting purposes if such contracts are experience-rated as a unit. Where individual contracts are provided, the entire group of such individual contracts with each carrier may be treated as a unit for purposes of this report.

8 (a) Contract or identification number	(b) Type of benefit	(c) List gross premium for each contract	(d) Premium rate or subscription charge
UNE 15147	Group Health	89062.3:	Age Rate

9 Experience-rated contracts: a Premiums: *(i)* Amount received

(ii) Increase (decrease) in amount due but unpaid

(iii) Increase (decrease) in unearned premium reserve

(iv) Premiums earned, add (i) and (ii), and subtract (iii)

b Benefit charges: *(i)* Claims paid

(ii) Increase (decrease) in claim reserves

(iii) Incurred claims, add (i) and (ii)

(iv) Claims charged

c Remainder of premium: *(i)* Retention charges (on an accrual basis)—(A) Commissions

(B) Administrative service or other fees

(C) Other specific acquisition costs

(D) Other expenses

(E) Taxes

(F) Charges for risks or contingencies

(G) Other retention charges

(H) Total retention

(ii) Dividends or retroactive rate refunds. (These amounts were ☐ paid in cash, or ☐ credited.)

d Status of policyholder reserves at end of year: *(i)* Amount held to provide benefits after retirement

(ii) Claim reserves

(iii) Other reserves

e Dividends or retroactive rate refunds due (do not include amount entered in c(ii))

10 Nonexperience-rated contracts: a Total premiums or subscription charges paid to carrier 89062.30

b If the carrier, service, or other organization incurred any specific costs in connection with the acquisition or retention of the contract or policy, other than reported in 3 above, report amount

Specify nature of costs ▶ Excess Indeminity Insurance

If additional space is required for any item, attach additional sheets the same size as this form.

General Instructions

This schedule must be attached to Form 5500, 5500-C, or 5500-R for every defined benefit, defined contribution, and welfare benefit plan where any benefits under the plan are provided by an insurance company, insurance service, or other similar organization.

Specific Instructions

(References are to the line items on the form.)

Include only contracts with policy or contract years ending with or within the plan year (for reporting purposes a year cannot exceed 12 months). Data on Schedule A (Form 5500) should be reported only for such policy or contract years. Exception: *If the insurance company maintains records on the basis of a plan year rather than policy or contract year, data on Schedule A (Form 5500) may be reported for the plan year.*

Include only the contracts issued to the plan for which this return/report is being filed.

Plans Participating in Master Trust(s) and 103-12 IEs—See the Form 5500 or Form 5500-C instructions for "Reporting Requirements for Investment Arrangements Filing With DOL."

2(c).—Since the plan coverage may fluctuate during the year, the number of persons entered should be that which the administrator determines will most reasonably reflect the number covered by the plan at the end of the policy or contract year.

Where contracts covering individual employees are grouped, entries should be determined as of the end of the plan year.

2(d) and (e).—Enter the beginning and ending dates of the policy year for each contract listed under column (b). Where separate contracts covering individual employees are grouped, enter "N/A" in column (d).

3.—All sales commissions are to be reported in column (c) regardless of the identity of the recipient. Override commissions, salaries, bonuses, etc., paid to a general agent or manager for managing an agency, or for performing other administrative functions, are not to be reported.

Fees to be reported in column (d) represent payments by insurance carriers to agents and brokers for items other than commissions (e.g., service fees, consulting fees, and finders fees).

Note: *For purposes of this item, commissions and fees include amounts paid by an insurance company on the basis of the aggregate value (e.g., policy amounts, premiums) of contracts or policies (or classes thereof) placed or retained. The amount (or pro rata share of the total) of such commissions or fees attributable to the contract or policy placed with or retained by the plan must be reported in column (c) or (d), as appropriate.*

Fees paid by insurance carriers to persons other than agents and brokers should be reported in Parts II and III on Schedule A (Form 5500) as acquisition costs, administrative charges, etc., as appropriate. For plans with 100 or more participants, fees paid by employee benefit plans to agents, brokers, and other persons are to be reported on Schedule C (Form 5500).

5a.—The rate information called for here may be furnished by attachment of appropriate schedules of current rates filed with appropriate state insurance departments or by a statement as to the basis of the rates.

6.—Show deposit fund amounts rather than experience credit records when both are maintained.

8(d).—The rate information called for here may be furnished by attachment of appropriate schedules of current rates or by a statement as to the basis of the rates.

SCHEDULE A
(Form 5500)
Department of the Treasury
Internal Revenue Service
Department of Labor
Pension and Welfare Benefits Administration
Pension Benefit Guaranty Corporation

Insurance Information

This schedule is required to be filed under section 104 of the Employee Retirement Income Security Act of 1974.

▶ File as an Attachment to Forms 5500, 5500-C, or 5500-R.

▶ Insurance companies are required to provide this information as per ERISA section 103(a)(2).

OMB No. 1210-0016

1988

This Form Is Open to Public Inspection

For calendar year 1988 or fiscal plan year beginning 6-1-88, 1988 and ending 12-31, 1988.

▶ Part I must be completed for all plans required to file this schedule.
▶ Part II must be completed for all insured pension plans.
▶ Part III must be completed for all insured welfare plans.

▶ Enter master trust or 103-12 IE name in place of "sponsor" and specify investment account or 103-12 IE in place of "plan" if filing with DOL for a master trust or 103-12 IE.

Name of plan sponsor as shown on line 1a of Form 5500, 5500-C, or 5500-R: Summit Insurance Plan Trust

Employer identification number: 72-1059059

Name of plan: Same

Enter three-digit plan number ▶ 501

Part I **Summary of All Insurance Contracts Included in Parts II and III**
Group all contracts in the same manner as in Parts II and III.

1 Check appropriate box: a ☑ Welfare plan b ☐ Pension plan c ☐ Combination pension and welfare plan

2 Coverage:

(a) Name of insurance carrier	(b) Contract or identification number	(c) Approximate number of persons covered at end of policy or contract year	Policy or contract year (d) From	Policy or contract year (e) To
Security Life Ins Company	501	2219	6-1-88	12-31-88

3 Insurance fees and commissions paid to agents and brokers:

(a) Contract or identification number	(b) Name and address of the agents or brokers to whom commissions or fees were paid	(c) Amount of commissions paid	(d) Fees paid Amount	(d) Fees paid Purpose
	Group Programs Inc P.O. Box 1210 Breaux Bridge LA 70517	7333.17		
Total				

4 Premiums due and unpaid at end of the plan year ▶ $ 0 : Contract or identification number ▶

Part II **Insured Pension Plans** Provide information for each contract on a separate Part II. Where individual contracts are provided, the entire group of such individual contracts with each carrier may be treated as a unit for purposes of this report.

▶ Contract or identification number ▶

5 Contracts with allocated funds, for example, individual policies or group deferred annuity contracts:
a State the basis of premium rates ▶
b Total premiums paid to carrier
c If the carrier, service, or other organization incurred any specific costs in connection with the acquisition or retention of the contract or policy, other than reported in 3 above, enter amount
Specify nature of costs ▶

6 Contracts with unallocated funds, for example, deposit administration or immediate participation guarantee contracts. Do not include portions of these contracts maintained in separate accounts:
a Balance at the end of the previous policy year
b Additions: (i) Contributions deposited during year
(ii) Dividends and credits
(iii) Interest credited during the year
(iv) Transferred from separate account
(v) Other (specify) ▶
(vi) Total additions
c Total of balance and additions, add a and b(vi)
d Deductions:
(i) Disbursed from fund to pay benefits or purchase annuities during year
(ii) Administration charge made by carrier
(iii) Transferred to separate account
(iv) Other (specify) ▶
(v) Total deductions
e Balance at end of current policy year, subtract d(v) from c

7 Separate accounts: Current value of plan's interest in separate accounts at year end

For Paperwork Reduction Act Notice, see page 1 of the Instructions for Form 5500 or 5500-C.

Schedule A (Form 5500) 1988

Schedule A (Form 5500) 1988 Summit Insurance Plan Trust 72-1059059 Page 2

Part III **Insured Welfare Plans**

Provide information for each contract on a separate Part III. If more than one contract covers the same group of employees of the same employer(s) or members of the same employee organization(s), the information may be combined for reporting purposes if such contracts are experience-rated as a unit. Where individual contracts are provided, the entire group of such individual contracts with each carrier may be treated as a unit for purposes of this report.

8 (a) Contract or identification number	(b) Type of benefit	(c) List gross premium for each contract	(d) Premium rate or subscription charge
3000-04	Life	73332.11	Age Rate

9 Experience-rated contracts: a Premiums: (i) Amount received . . . . .
(ii) Increase (decrease) in amount due but unpaid . . . . .
(iii) Increase (decrease) in unearned premium reserve . . . . .
(iv) Premiums earned, add (i) and (ii), and subtract (iii) . . . . .
b Benefit charges: (i) Claims paid . . . . .
(ii) Increase (decrease) in claim reserves . . . . .
(iii) Incurred claims, add (i) and (ii) . . . . .
(iv) Claims charged . . . . .
c Remainder of premium: (i) Retention charges (on an accrual basis)—(A) Commissions . . . . .
(B) Administrative service or other fees . . . . .
(C) Other specific acquisition costs . . . . .
(D) Other expenses . . . . .
(E) Taxes . . . . .
(F) Charges for risks or contingencies . . . . .
(G) Other retention charges . . . . .
(H) Total retention . . . . .
(ii) Dividends or retroactive rate refunds. (These amounts were ☐ paid in cash, or ☐ credited.) . . . . .
d Status of policyholder reserves at end of year: (i) Amount held to provide benefits after retirement . . . . .
(ii) Claim reserves . . . . .
(iii) Other reserves . . . . .
e Dividends or retroactive rate refunds due (do not include amount entered in c(ii)) . . . . .
10 Nonexperience-rated contracts: a Total premiums or subscription charges paid to carrier 73332.11
b If the carrier, service, or other organization incurred any specific costs in connection with the acquisition or retention of the contract or policy, other than reported in 3 above, report amount . . . . .
Specify nature of costs ▶ Excess Indemnity Insurance

If additional space is required for any item, attach additional sheets the same size as this form.

General Instructions

This schedule must be attached to Form 5500, 5500-C, or 5500-R for every defined benefit, defined contribution, and welfare benefit plan where any benefits under the plan are provided by an insurance company, insurance service, or other similar organization.

Specific Instructions

(References are to the line items on the form.)

Include only contracts with policy or contract years ending with or within the plan year (for reporting purposes a year cannot exceed 12 months). Data on Schedule A (Form 5500) should be reported only for such policy or contract years. Exception: *If the insurance company maintains records on the basis of a plan year rather than policy or contract year, data on Schedule A (Form 5500) may be reported for the plan year.*

Include only the contracts issued to the plan for which this return/report is being filed.

Plans Participating in Master Trust(s) and 103-12 IEs—See the Form 5500 or Form 5500-C instructions for "Reporting Requirements for Investment Arrangements Filing With DOL."

2(c).—Since the plan coverage may fluctuate during the year, the number of persons entered should be that which the administrator determines will most reasonably reflect the number covered by the plan at the end of the policy or contract year.

Where contracts covering individual employees are grouped, entries should be determined as of the end of the plan year.

2(d) and (e).—Enter the beginning and ending dates of the policy year for each contract listed under column (b). Where separate contracts covering individual employees are grouped, enter "N/A" in column (d).

3.—All sales commissions are to be reported in column (c) regardless of the identity of the recipient. Override commissions, salaries, bonuses, etc., paid to a general agent or manager for managing an agency, or for performing other administrative functions, are not to be reported.

Fees to be reported in column (d) represent payments by insurance carriers to agents and brokers for items other than commissions (e.g., service fees, consulting fees, and finders fees).

Note: *For purposes of this item, commissions and fees include amounts paid by an insurance company on the basis of the aggregate value (e.g., policy amounts, premiums) of contracts or policies (or classes thereof) placed or retained. The amount (or pro rata share of the total) of such commissions or fees attributable to the contract or policy placed with or retained by the plan must be reported in column (c) or (d), as appropriate.*

Fees paid by insurance carriers to persons other than agents and brokers should be reported in Parts II and III on Schedule A (Form 5500) as acquisition costs, administrative charges, etc., as appropriate. For plans with 100 or more participants, fees paid by employee benefit plans to agents, brokers, and other persons are to be reported on Schedule C (Form 5500).

5a.—The rate information called for here may be furnished by attachment of appropriate schedules of current rates filed with appropriate state insurance departments or by a statement as to the basis of the rates.

6.—Show deposit fund amounts rather than experience credit records when both are maintained.

8(d).—The rate information called for here may be furnished by attachment of appropriate schedules of current rates or by a statement as to the basis of the rates.

(Form 5500)
Department of the Treasury
Internal Revenue Service
Department of Labor
Pension and Welfare Benefits Administration
Pension Benefit Guaranty Corporation

This schedule is required to be filed under section 104 of the Employee Retirement Income Security Act of 1974, referred to as ERISA, and section 6059(a) of the Internal Revenue Code, referred to as the Code.

▶ **Attach to Forms 5500, 5500-C, 5500-R, or 5500EZ if applicable.**

1988

This Form Is Open to Public Inspection

For calendar plan year 1988 or fiscal plan year beginning 6-1, 1988, and ending 12-31, 1988.

▶ **Please complete every item on this form. If an item does not apply, enter "N/A."** ▶ **Round off amounts to nearest dollar.**

▶ **Caution: A penalty of $1,000 will be assessed for late filing of this report unless reasonable cause is established.**

Name of plan sponsor as shown on line 1a of Form 5500, 5500-C, 5500-R, or 5500EZ: Summit Insurance Plan Trust

Employer identification number: 72: 1059059

Name of plan: Same

Enter three-digit plan number ▶ 5 0 1

	Yes	No
1 Has a waiver of a funding deficiency for this plan been approved by the IRS?		X
If "Yes," attach a copy of the IRS approval letter.		
2 Is a waived funding deficiency of a prior plan year being amortized in this plan year?		X
3 Have any of the periods of amortization for charges described in Code section 412(b)(2)(B) been extended by IRS?		X
If "Yes," attach a copy of the IRS approval letter.		
4a Was the shortfall funding method the basis for this plan year's funding standard account computations?		X
b Is this plan a multiemployer plan which is, for this plan year, in reorganization as described in Code section 418 or ERISA section 4241?		X
If "Yes," you are required to attach the information described in the instructions.		
5 Has a change in funding method for this plan year been made?		X

If "Yes," attach either a copy of the letter showing IRS approval or state applicable Revenue Procedure authorizing approval if used.

6 Operational information:

a Enter most recent actuarial valuation date ▶ June 1, 1988

b Enter date(s) and amount of contributions received this plan year for prior plan years and not previously reported:

Date(s) ▶ Amount ▶ None

c Current value of the assets accumulated in the plan as of the beginning of the plan year	0
d Present value of vested benefits as of the beginning of the plan year:	
(i) For retired participants and beneficiaries receiving payments	0
(ii) For other participants	0
(iii) Total	0
e Present value of nonvested accrued benefits as of the beginning of the plan year	0
f Number of persons covered (included in the most recent actuarial valuation):	
(i) Active participants	2219
(ii) Terminated participants with vested benefits	0
(iii) Retired participants and beneficiaries of deceased participants	

7 Contributions made to the plan for the plan year by employer(s) and employees:

(a) Month Year	(b) Amount paid by employer	(c) Amount paid by employees	(a) Month Year	(b) Amount paid by employer	(c) Amount paid by employees
			Total . . .	1,893,420.33	← combined

Statement by Enrolled Actuary (see instructions before signing):

To the best of my knowledge, the information supplied in this schedule and on the accompanying statement, if any, is complete and accurate, and in my opinion the assumptions used in the aggregate (a) are reasonably related to the experience of the plan and to reasonable expectations, and (b) represent my best estimate of anticipated experience under the plan.

Patrick Huval
Signature of actuary

8-30-89
Date

Patrick Huval
Print or type name of actuary

N/A
Enrollment number

P.O. Box 360 Breaux Bridge LA 70517
Name and address

(318) 332-2157
Telephone number (including area code)

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11

8 Funding standard account and other information.	
a Accrued liabilities as determined for funding standard account as of (enter date) ▶ 12-31-88	0
b Value of assets as determined for funding standard account as of (enter date) ▶ 12-31-88	0
c Unfunded liability for spread-gain methods with bases as of (enter date) ▶ 12-31-88	0
d (i) Actuarial gains or (losses) for period ending ▶ 12-31-88	0
(ii) Shortfall gains or (losses) for period ending ▶ 12-31-88	0
e Amount of contribution certified by the actuary as necessary to reduce the funding deficiency to zero, from 9m or 10h (or the attachment for 4b if required)	0
9 Funding standard account statement for this plan year ending ▶ 12-31-88	
Charges to funding standard account: **a** Prior year funding deficiency, if any	0
b Employer's normal cost for plan year as of mo. 12 day 31 yr. 88 (Includes Employee Contribution)	1,893,420.33
c Amortization charges	
(i) Funding waivers (outstanding balance as of mo. N/A day ..... yr. .... ▶ $ ....)	
(ii) Other than waivers (outstanding balance as of mo. N/A day ..... yr. .... ▶ $ ....)	
d Interest as applicable to the end of the plan year on a, b, and c	0
e Total charges (add a through d)	1,893,420.33
Credits to funding standard account:	
f Prior year credit balance, if any	
g Employer contributions (total from column (b) of item 7) (Includes Employee Contribution)	1,893,420.33
h Amortization credits (outstanding balance as of mo. .... day .... yr. .... ▶ $ ....)	
i Interest as applicable to end of plan year on f, g, and h	0
j Other (specify) ▶	
k Total credits (add f through j)	1,893,420.33
Balance:	
l Credit balance: if k is greater than e, enter the difference	0
m Funding deficiency: if e is greater than k, enter the difference	0

10 Alternative minimum funding standard account (omit if not used):

a Was the entry age normal cost method used to determine entries in item 9 above? ☐ Yes ☐ No
If "No," do not complete b through h.

b Prior year alternate funding deficiency, if any	
c Normal cost	
d Excess, if any, of value of accrued benefits over market value of assets	
e Interest on b, c, and d	
f Employer contributions (total from column (b) of item 7)	
g Interest on f	
h Funding deficiency: if the sum of b through e is greater than the sum of f and g, enter difference	

11 Actuarial cost method used as the basis for this plan year's funding standard account computation:

a ☑ Attained age normal **b** ☐ Entry age normal **c** ☐ Accrued benefit (unit credit)
d ☐ Aggregate **e** ☐ Frozen initial liability **f** ☐ Individual level premium
g ☐ Other (specify) ▶

12 Checklist of certain actuarial assumptions:	A Used for items 6d and e—value of accrued benefits				B Used for items 8, 9, or 10—funding standard account			
	Pre-retirement		Post-retirement		Pre-retirement		Post-retirement	
a Rates specified in insurance or annuity contracts	☐ Yes	☐ No	☐ Yes	☐ No	☐ Yes	☐ No	☐ Yes	☐ No
b Mortality table code:								
(i) Males	N/A		N/A		N/A		N/A	
(ii) Females								
c Interest rate	%		%		%		%	
d Retirement age								
e Expense loading	%		%		%		%	
f Annual withdrawal rate:	Male	Female			Male	Female		
(i) Age 25	%	%			%	%		
(ii) Age 40	%	%			%	%		
(iii) Age 55	%	%			%	%		
g Ratio of salary at normal retirement to salary at:								
(i) Age 25					%	%		
(ii) Age 40					%	%		
(iii) Age 55					%	%		

h Investment return on actuarial value of plan assets for the year ending on the valuation date %

SCHEDULE C
(Form 5500)
Department of the Treasury
Internal Revenue Service
Department of Labor
Pension and Welfare Benefits Administration
Pension Benefit Guaranty Corporation

Service Provider and Trustee Information

This schedule is required to be filed under section 104 of the Employee Retirement Income Security Act of 1974.

▶ File as an Attachment to Form 5500.

Additional Schedules C (Form 5500) may be used, if needed, to provide additional information for Parts I, II, and/or III.

OMB No. 1210-0016

1988

This Form is Open to Public Inspection

For the calendar year 1988 or fiscal plan year beginning , 1988, and ending , 19

Name of plan sponsor as shown on line 1a of Form 5500: Summit Insurance Plan Trust

Employer identification number: 72 : 1059059

Name of plan: Same

Enter three-digit plan number ▶

Part I Service Provider Information (see instructions)

	(a) Name	(b) Employer identification number (see instructions)	(c) Official plan position	(d) Relationship to employer, employee organization, or person known to be a party-in-interest	(e) Gross salary or allowances paid by plan	(f) Fees and commissions paid by plan	(g) Nature of service code (see instructions)
(1)	Group Programs, Inc	72-1045988	Contract administrator	None	—	277953.74	13
(2)			—				
(3)							
(4)							
(5)							
(6)							
(7)							
(8)							
(9)							
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(32)							
(33)							
(34)							
(35)							
(36)							
(37)							
(38)							
(39)							
(40)							

For Paperwork Reduction Act Notice, see page 1 of the Instructions for Form 5500. **Schedule C (Form 5500) 1988**

5/22/89

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required to supply this information, attach additional

Name First Nat'l Bank of Nashville TN Address Nashville TN	Name Address
Name Address	Name Address
Name Address	Name Address
Name Address	Name Address
Name Address	Name Address
Name Address	Name Address
Name Address	Name Address
Name Address	Name Address

Part III **Termination Information (see instructions)**

(a) Name	(b) EIN	(c) Position	(d) Address	(e) Telephone No.

(1) **Explanation:**

(a) Name	(b) EIN	(c) Position	(d) Address	(e) Telephone No.

(2) **Explanation:**

(a) Name	(b) EIN	(c) Position	(d) Address	(e) Telephone No.

(3) **Explanation:**

Form **5558**
(Rev. March 1987)
Department of the Treasury
Internal Revenue Service

Application for Extension of Time

To File Certain Employee Plan Returns

▶ For Paperwork Reduction Act Notice, see instructions on back.

OMB No. 1545-0212
Expires 3-31-90

File With IRS Only

File in DUPLICATE by the due date for filing the return. (See general instructions 2 and 3.)

Name of taxpayer or plan sponsor (see instructions): Summit Insurance Plan Trust
Address (number and street): P.O. Box 360
City or town, state, and ZIP code: Breaux Bridge LA 70517

Check applicable box and enter number (see specific instructions).
☑ Employer identification number (EIN). Filers checking any box in 1a through 1d must enter an EIN. All other filers see specific instructions.
▶ 72-1059257 OR
☐ Social security number. Form 5330 filers see instructions.
▶

1 I request an extension of time until (see specific instructions) ▶ .... (check appropriate block(s)):
- a ☑ To file Form 5500, Annual Return/Report of Employee Benefit Plan (with related schedules).
- b ☐ To file Form 5500-C, Return/Report of Employee Benefit Plan (with related schedules).
- c ☐ To file Form 5500-R, Registration Statement of Employee Benefit Plan (with related schedules).
- d ☐ To file Form 5500EZ, Return of One-Participant Pension Benefit Plan (with related schedule).
- e ☐ To file Form 5330, Return of Initial Excise Taxes Related to Employee Benefit Plans, for tax year beginning ▶ .... and ending ▶ ....

2 If you checked e above, are you electing to be taxed under ERISA section 2003(c)(1)(B)? ☐ Yes ☐ No

3 If you have never filed a Form 5500, 5500-C, 5500-R, or 5500EZ for your plan, check this box ▶ ☑

4 Complete the following for the plan covered by this application (see general instruction 2):

Plan name	Plan number	Plan year ending		
		Month	Day	Year
Summit Insurance Plan Trust		12	31	88

5 a Has an extension of time to file the designated return(s) been previously granted for this tax year? ☐ Yes ☑ No
b If "Yes," show the date(s) to which the extension was granted ▶ ....

6 Attach a detailed statement of why you need the extension (see specific instructions).

7 If the extension is for Form 5330, enter the amount of tax estimated to be due on Form 5330. Pay this amount with this application ▶

Caution: *Interest on late payment of tax accrues at the rate established under section 6621(a)(2) of the Internal Revenue Code from the regular due date of the return until paid. (For the penalty for late payment of tax, see specific instructions.)*

Under penalties of perjury, I declare that to the best of my knowledge and belief the statements made on this form are true, correct, and complete and that I am authorized to prepare this application.

Signature ▶ Patrick Huval Date ▶ 7-27-89

Note: *The person who signs this form may be an employer or plan administrator filing Form 5500, 5500-C, 5500-R, 5500EZ, or 5330; a disqualified person filing Form 5330; an attorney or certified public accountant qualified to practice before the IRS; a person enrolled to practice before the IRS; or a person holding a power of attorney.*

Notice to Applicant.—The Internal Revenue Service will indicate below whether the extension is granted or denied and will return the original of the application.

☐ The application IS approved to ▶ .... (You MUST attach a copy of this form to each return you file for which an extension is granted.)

☐ The application IS NOT approved. (You MUST attach a copy of this form to each return you file for which a grace period is granted.) However, in view of your reasons stated in the application, a 10-day grace period is granted from the date shown below or due date of the return, whichever is later. This 10-day grace period constitutes a valid extension of time for purposes of elections otherwise required to be made on timely filed returns.

☐ The application IS NOT approved.
After consideration of the reasons stated in your application, we have determined the extension is not warranted. (The 10-day grace period is not granted.)

☐ The application cannot be considered, since you filed it after the due date of the return.

☐ Other ▶ ....

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Reason for extension:

We are requesting an extension of time to file because of the lack of complete information available. We are missing just a few items, but expect to have these by the beginning of August. Therefore, we are requesting extensions until 8-31-89.

This is the first time that we file Form 5500.

The returns will represent the period from June 1, 1988 to December 31, 1988

These plans are administered by:

Group Programs, Inc
P.O. Box 360
Breaux Bridge, LA 70517
72-1045988

Form **5500-C**
Department of the Treasury
Internal Revenue Service
Department of Labor
Pension and Welfare Benefits Administration
Pension Benefit Guaranty Corporation

Return/Report of Employee Benefit Plan

(With fewer than 100 participants)

This form is required to be filed under sections 104 and 4065 of the Employee Retirement Income Security Act of 1974 and sections 6039D, 6057(b), and 6058(a) of the Internal Revenue Code, referred to as the Code.

OMB No. 1210-0016

1988

This Form is Open to Public Inspection.

For the calendar plan year 1988 or fiscal plan year beginning ...., 19..... and ending Dec 31, 1988

If your plan year changed since the last return/report filed, check this box ▶ ☐

Type or print in ink all entries on the form, schedules, and attachments. If an item does not apply, enter "N/A." File the originals.

If *(i)* through *(iii)* do not apply to this year's return/report, leave the boxes unmarked. This return/report is:

Corrected Report – See attached letter

(i) ☒ the first return/report filed for the plan; *(ii)* ☐ an amended return/report; or *(iii)* ☐ the final return/report filed for the plan.

- ▶ Welfare benefit plans and fringe benefit plans need only complete certain items or may not be required to file—see instructions "What to File."
- ▶ One-participant plans file Form 5500EZ for 1988.
- ▶ If you have been granted an extension of time to file this form, you must attach a copy of the approved extension to this form.

To mailing address to
P.O. Box 9037 Ontario, Calif 91761

Use IRS label. Otherwise, please print or type.

1a Name of plan sponsor (employer, if for a single-employer plan): UNITED HEALTH CARE BENEFITS TRUST.
Address (number and street): 1785 Arrow Route A-1.
City or town, state, and ZIP code: UPLAND, CALIF 91786.
1b Employer identification number: 33 6069906.
1c Telephone number of sponsor: (714) 981-3001.
1d Business code number: N/A.
1e CUSIP issuer number: N/A

2a Name of plan administrator (if same as plan sponsor, enter "Same"): UNITED HEALTH INS ADMINISTRATOR.
Address (number and street): 1785 Arrow Route A-1.
City or town, state, and ZIP code: UPLAND. CALIF 91786.
2b Administrator's employer identification no.: 33 0213003.
2c Telephone number of administrator: (714 981-3001.

3 Are the name, address, and employer identification number (EIN) of the plan sponsor and/or plan administrator the same as they appeared on the last return/report filed for this plan? ☐ Yes ☐ No If "No," enter the information from the last return/report in a and/or b, and complete c.
a Sponsor ▶ N/A EIN .... Plan number ....
b Administrator ▶ N/A EIN ....
c If a indicates a change in the sponsor's name and EIN, is this a change in sponsorship only? (See specific instructions for definition of sponsorship.) ☐ Yes ☐ No

4 Check box to indicate the type of plan entity (check only one box):
a ☐ Single-employer plan
b ☐ Plan of controlled group of corporations or common control employers
c ☐ Multiemployer plan
d ☐ Multiple-employer-collectively-bargained plan
e ☒ Multiple-employer plan (other)
f ☐ Exceptions to (b) and (e). (See instructions for line 4f.)

5a *(i)* Name of plan ▶ UNITED HEALTH CARE BENEFITS TRUST
(ii) ☐ Check if name of plan changed since the last return/report
(iii) ☐ Check this box if this plan covers self-employed participants
5b Effective date of plan: JULY 1987.
5c Enter three-digit plan number ▶ 502

6a ☒ Welfare benefit plan (plan numbers 501 through 999) must check applicable items A through P and 6c
(i) ☒ Type
A ☒ Health (other than dental or vision)
B ☒ Life insurance
C ☐ Supplemental unemployment
D ☒ Dental
E ☒ Vision
F ☒ Temporary disability (accident and sickness)
G ☐ Prepaid legal
H ☒ Long-term disability
I ☐ Severance pay
J ☐ Apprenticeship and training
K ☐ Scholarship (funded)
L ☐ Death benefits other than life insurance
M ☐ Code section 120 (group legal services plan)
N ☐ Code section 125 (cafeteria plan)
O ☐ Code section 127 (educational assistance plan)
P ☒ Other (specify) Retiree Medical Benefits
(ii) If you checked M, N, or O, check if plan is: ☐ funded or ☐ unfunded

6b ☐ Pension benefit plan (plan numbers 001 through 500) must check applicable items in (i) through (vii) and answer 6c through 6f.
(i) ☐ Defined benefit plan
(ii) ☐ Defined contribution plan—(indicate type of defined contribution): (A) ☐ Profit-sharing (B) ☐ Stock bonus (C) ☐ Target benefit (D) ☐ Other money purchase (E) ☐ Other (specify) ▶ ....
(iii) ☐ Defined benefit plan with benefits based partly on balance of separate account of participant (Code section 414(k))
(iv) ☐ Annuity arrangement of certain exempt organizations (Code section 403(b)(1))
(v) ☐ Custodial account for regulated investment company stock (Code section 403(b)(7))
(vi) ☐ Pension plan utilizing individual retirement accounts or annuities (described in Code section 408) as the sole funding vehicle for providing benefits
(vii) ☐ Other (specify) ▶

Under penalties of perjury and other penalties set forth in the instructions, I declare that I have examined this return/report, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

Date ▶ 6/15/89 Signature of employer/plan sponsor ▶ X UHBT Trustee.
Date ▶ 6/15/89 Signature of plan administrator ▶ X U.H.I.A. Pres.

X For Paperwork Reduction Act Notice, see page 1 of the instructions. Form **5500-C** (1988)

Also Enclosed Are The uncorrected Tax-Returns. Schedule A.

Form 5500-C (1988) Page 2

→ THE TRUST IS REINSURED AFTER $50,000, THERE IS NO DIRECT INSURANCE FOR PARTICIPANTS, NO BENEFITS ARE PAID DIRECTLY TO BENEFICIARIES, BUT ARE PAID ONLY TO TRUST)

Other plan features: *(i)* ☐ ESOP *(ii)* ☐ Leveraged ESOP *(iii)* ☐ Participant-directed account plan
(iv) ☐ Pension plan maintained outside the United States *(v)* ☐ Master trust (see instructions)
(vi) ☐ 103-12 investment entity (see instructions) *(vii)* ☐ Common/Collective trust *(viii)* ☐ Pooled separate account

		Yes	No
Single-employer plans enter the tax year end of the employer in which this plan year ends ▶ Month ______ Day ____ Year ______			
Is the employer a member of an affiliated service group?	e		X
Does this plan contain a cash or deferred arrangement described in Code section 401(k)?	f	-	X

Total participants: *(i)* Beginning of plan year ......0...... *(ii)* End of plan year ......18......

		Yes	No
(i) Were any participants in the pension benefit plan separated from service with a deferred vested benefit for which a Schedule SSA (Form 5500) is required to be attached?	(i)		
(ii) If "Yes," enter the number of separated participants required to be reported ▶			
Were any plan amendments adopted during the plan year?	a		X
Did any amendment result in the retroactive reduction of accrued benefits for any participant?	b		
Enter the date the most recent amendment was adopted ▶ Month ______ Day ______ Year ______			
If a is "Yes," did any amendment change the information contained in the latest summary plan descriptions or summary description of modifications available at the time of the amendment?	d		
Has a summary plan description or summary description of modifications that reflects the plan amendments referred to in d been furnished to participants and filed with the Department of Labor?	e		
Was this plan terminated during this plan year or any prior plan year? If "Yes," enter year ▶ N/A	9a		
Were all plan assets either distributed to participants or beneficiaries, transferred to another plan, or brought under the control of PBGC?	b		
Was a resolution to terminate this plan adopted during this plan year or any prior plan year?	c		
If a or c is "Yes," have you received a favorable determination letter from IRS for the termination?	d		
If d is "No," has a determination letter been requested from IRS?	e		
If a or c is "Yes," have participants and beneficiaries been notified of the termination or the proposed termination?	f		
If a is "Yes" and the plan is covered by PBGC, is the plan continuing to file a PBGC Form 1 and pay premiums until the end of the plan year in which assets are distributed or brought under the control of PBGC?	g		
h During this plan year, did any trust assets revert to the employer for which the Code section 4980 excise tax is due?	h		
If h is "Yes," enter the amount of tax paid with your Form 5330 ▶			
10a Was this plan merged or consolidated into another plan(s), or were assets or liabilities transferred to another plan(s) since the end of the plan year covered by the last return/report Form 5500 or 5500-C which was filed for this plan (or during this plan year if this is the initial return/report)?	10a		X

If "Yes," identify the other plan(s):

b Name of plan(s) ▶

c Employer identification number(s)

d Plan number(s)

e Has Form 5310 been filed? ☐ Yes ☐ No

11 Enter the plan funding arrangement code (see instructions) ▶ 8

12 Enter the plan benefit arrangement code (see instructions) ▶ 6 - (See #11 + EXPLANATION)

		Yes	No
13 Is this a plan established or maintained pursuant to one or more collective bargaining agreements?	13		X
14 If any benefits are provided by an insurance company, insurance service, or similar organization, enter the number of Schedules A (Form 5500), Insurance Information, that are attached. If none, enter "-0-" ▶ ATTACHED (SEE EXPLANATION ON ATTACHED FORM)			

Welfare Plans Do Not Complete Items 15 Through 28. Skip to Item 29.

		Yes	No
15a If this is a defined benefit plan, is it subject to the minimum funding standards for this plan year? If "Yes," attach Schedule B (Form 5500).	a		
b If this is a defined contribution plan, i.e., money purchase or target benefit, is it subject to the minimum funding standards (If a waiver was granted, see instructions)?	b		

If "Yes," complete *(i)*, *(ii)*, and *(iii)* below:

(i) Amount of employer contribution required for the plan year under Code section 412 (i) $

(ii) Amount of contribution paid by the employer for the plan year (ii) $

Enter date of last payment by employer ▶ Month ______ Day ______ Year ______

(iii) If *(i)* is greater than *(ii)*, subtract *(ii)* from *(i)* and enter the funding deficiency here. Otherwise, enter zero. (If you have a funding deficiency, file Form 5330.) (iii) $

		Yes	No
16 Has the plan been top-heavy at any time beginning with the 1984 plan year?	16		
17 Has the plan accepted any transfers or rollovers with respect to a participant who has attained age 70½?	17		

			Yes	No	Amount
i	Has any plan fiduciary had a financial interest in excess of 10% in any party providing services to the plan or received anything of value from any such party?	29i		X	
j	Did the plan at any time hold 20% or more of its assets in any single security, debt, mortgage, parcel of real estate, or partnership/joint venture interests?	j		X	
k	Did the plan at any time engage in any transaction or series of related transactions involving 20% or more of the current value of plan assets?	k		X	
l	Were there any noncash contributions made to the plan whose value was set without an appraisal by an independent third party?	l		X	
m	Were there any purchases of nonpublicly traded securities by the plan whose value was set without an appraisal by an independent third party?	m		X	
n	Has the plan failed to provide any benefit when due under the terms of the plan because of insufficient assets?	n		X	

30 Current value of plan assets and liabilities at the beginning and end of the plan year. Combine the value of plan assets held in more than one trust. Allocate the value of the plan's interest in a commingled trust containing the assets of more than one plan on a line-by-line basis unless the trust meets one of the specific exceptions described in the instructions. Do not enter the value of that portion of an insurance contract which guarantees during this plan year to pay a specific dollar benefit at a future date. Round off amounts to the nearest dollar.

			(a) Beginning of year	(b) End of year
	Assets			
a	Cash Premiums Received:	a	#	2,349
b	Receivables	b		
c	Investments:			
	(i) U.S. Government securities	(i)		
	(ii) Corporate debt and equity instruments	(ii)		
	(iii) Real estate and mortgages (other than to participants)	(iii)		
	(iv) Loans to participants:			
	A Mortgages	A		
	B Other	B		
	(v) Other	(v)		
	(vi) Total investments (add (i) through (v))	(vi)		
d	Buildings and other property used in plan operations	d		
e	Other assets	e		
f	Total assets	f	#	2,349
	Liabilities			
g	Payables	g		
h	Acquisition indebtedness	h		
i	Other liabilities	i		
j	Total liabilities	j		
k	Net assets (f minus j)	k	#	2,349.

31 Plan income, expenses, and changes in net assets for the plan year. Include all income and expenses of the plan including any trust(s) or separately maintained fund(s) and payments/receipts to/from insurance carriers.

			(a) Amount	(b) Total
	Income			
a	Contributions received or receivable in cash from:			
	(i) Employer(s) (including contributions on behalf of self-employed individuals)	(i)	#2,349.	
	(ii) Employees	(ii)	INCL.	
	(iii) Others	(iii)	INCL.	
b	Noncash contributions	b		
c	Earnings from investments (interest, dividends, rents, royalties)	c		
d	Net realized gain (loss) on sale or exchange of assets	d		
e	Other income (specify) ▶	e		
f	Total income (add a through e)	f		
	Expenses			
g	Distribution of benefits and payments to provide benefits:			
	(i) Directly to participants or their beneficiaries	(i)		
	(ii) Other	(ii)		
h	Administrative expenses (salaries, fees, commissions, insurance premiums)	h		
i	Other expenses (specify) ▶	i		
j	Total expenses (add g through i)	j		
k	Net income (loss) (subtract j from f)	k		#2,349.

ADMINISTRATIVE SERVICES CONTRACT

This Agreement made and entered into this day of October 26, 1988 by and between United Healthcare Benefit Trust (herein referred to as U.H.B.T. or "The Trust") and United Association of Small Businesses doing business as United Health Insurance Administrators herein referred to as U.H.I.A. or the Administrators.

RECITALS

A) U.H.B.T. is a trust established for the purpose of providing various group benefits primarily in the medical, dental, vision, disability, and death benefits field for employees and dependents of participating employers and for providing the medical, dental, vision, disability, and death benefits contained of ERISA ACT 1974.

B) The Trustee of U.H.B.T., among other things, are empowered under the Agreement and Declaration of Trust creating said Trust to employ an Administrator to assume and perform certain duties.

C) The Agreement and Declaration of Trust further provides that the Trustees and the Administrators may enter into and agreement setting the compensation of the Administrator and establishing in more detail the duties and function of the Administrator.

D) It is the desire of the parties to this Agreement that United Health Insurance Administrators immediately upon the effective date hereof begin to perform the duties of Administrator for participants of the Trust.

NOW THEREFORE, in consideration of the covenants and conditions hereinafter appearing, the parties agree as follows:

1) U.H.I.A. is hereby appointed as Administrator of the United Healthcare Benefit Trust to administer any and all group benefit plans established or adopted by U.H.B.T. will act as exclusive Administrator until it's resignation or removal as provided herein.

2) U.H.I.A. shall forthwith establish and maintain an administration office which shall be fully equipped to handle enrollment of participants in the Trust and their employees. The administration office shall be staffed with sufficient personnel and equipment to handle anticipated claims administration, premium accounting and any and all duties arising from this Agreement or as directed by the Trustees of U.H.B.T..

3) For the duration of this agreement and while group insurance policies or group benefit contracts are in effect, U.H.I.A. will perform the following functions as its capacity as Administrator:

   a) Issue plan description booklets to employees and their dependents.

   b) Prepare and deliver enrollment cards to employees and other material needed for each participating employers and members relating to requests for change of beneficiaries and the recording of such changes.

d) Assist insured employees relating to requests for change of beneficiaries and the recording of such changes.

e) Maintain appropriate records with respect to participating employers and insured employees and members.

f) Prepare premium statements and submit premium to carriers and prepaid plan contractors.

g) Bill and connect contributions and maintain records regarding same.

h) Send late notices, as well as the termination and reinstatement of policies or contracts.

i) Pay commissions to approved or licensed producers in accordance with their existing contracts if any.

j) Establish and maintain necessary contracts and commission accounting records.

k) Evaluate and process applications by participants for group benefit plans.

l) Where appropriate and pursuant to the terms of any of the group policies or contracts, evaluate and process individual employee applications, including statements of insurability.

m) Prepare for Trustees data relating to participating employers for the purpose of renewal or continuation of coverage.

n) Perform any other normal, general service function necessary or appropriate to the performance of this administration service agreement.

4) U.H.I.A. will perform the following claim processing and payment functions with respect to any group medical plan which involves claim payments:

a) Evaluate and process claims, including the acceptance or rejection of liability based upon benefit contracts.

b) Pay benefits and process benefit checks or drafts.

c) Establish and maintain claim records and other statistical data in connection there with.

d) Perform any other normal claim function.

5) U.H.I.A. is and independent contractor. Nothing contained in this Agreement shall create, or shall be construed to create, the relationship employer and employee between U.H.B.T. and U.H.I.A. nor shall U.H.I.A. officers or employees be considered employees of U.H.B.T. for any purpose whatsoever.

6) U.H.I.A. shall be fully responsible and accountable for the acts of it's employees in performing it's duties hereunder. However, shall not be held accountable or liable for any reasonable error in judgement or any reasonable clerical omission. The term "reasonable" shall be judged on normal insurance industry standards.

7a) For the service performed by U.H.I.A. under this agreement, U.H.B.T. agrees to pay U.H.I.A. the amounts listed in Exhibit "A" attached hereto and made a part hereof. U.H.I.A. shall deduct and retain the compensation listed in Exhibit "A" from contributions received which are due and payable while this Agreement is in force.

7b) U.H.B.T. Also Agrees to make loans, advances or pay commissions for marketing the benefits of U.H.B.T. directly or through U.H.I.A. at the sole discretion or direction of U.H.I.A. See schedules 1,2 &2B to Small Business Insurance Services or any other Marketing Company choosen by U.H.I.A.. U.H.B.T. shall receive interest for any loans or advances made by U.H.B.T. Directly or through U.H.I.A. (See Schedules 1A&2B)

7c) U.H.B.T. Agrees to pay stop-loss insurance premiums, fees for Preferred Providers Organization (PPO) or any other fee, costs and expenses of U.H.B.T.

U.H.B.T. Solely Authorizes United Association of Small Business (U.A.S.B.), United Health Insurance Administrators (U.H.I.A.) or any of it's authorized affiliates or any qualified company Authorized by U.A.S.B. or U.H.I.A. to collect all premiums, dues or other fees from policy holders/subscribers and disburse the premiums/dues to various parties for claims, loans, commissions, stoploss premiums, PPO Fees or other costs.

8) Accounts of money received for U.H.B.T. on business processed by U.H.I.A. pursuant to the Agreement shall be accounted for not later than sixty (60) days after the last day of the month for which the billing statements are sent.

U.H.B.T. agrees to defend and pay all costs of any action or suit brough against U.H.I.A. relating to or arising out of its performance under this Agreement, not arising from the gross negligence or fraud of U.H.I.A.. Without limiting the foregoing, it is specifically agreed by U.H.I.A. that whenever U.H.I.A. or any of it's affiliated companies or officers th[illegible]f are named as defendents in any litigation arising out of a disputed or rejected claim relating to the administration of the business covered under this Agreement, U.H.I.A. may at it's option, forward all legal documents and other material relating there to U.H.B.T. and U.H.B.T. agrees to file timely responsive pleadings on behalf of said defendant and shall take such other measure that are necessary to defend such actions on behalf of said defendant without cost or expense to said defendants.

10) This Agreement shall remain in full force and effect for a period of five (5) years from it's effective date; and thereafter this Agreement may be cancelled by either party by the giving of sixty (60) days written notice to the other.

11) U.H.I.A. agrees that it becomes insolvent or commits any act of bankruptcy, this Agreement shall terminate immediately. In the event U.H.I.A. becomes insolvent, all moneys held by U.H.I.A. owing to U.H.B.T. shall be forthwith paid to U.H.B.T. and any further moneys received as premium on policies shall forthwith be forthwith forwarded without reduction to U.H.B.T.

12) All records and files established and maintained by U.H.I.A. Under this Agreement are and shall remain the property of U.H.I.A. and may be reviewed, or copies may be reproduced at U.H.B.T.'s expense and by U.H.B.T. at any time upon reasonable notice subject however to the absolute right of U.H.B.T. to obtain from U.H.I.A. and maintain all Trust records upon satisfying all requirements of the Employee Retirement Income Security Act of 1974 (ERISA).

13) This Agreement is executed in the State of California and shall be governed by the laws of said state.

This Agreement is executed in Glendora, California this 26th day of October, 1988. The effective date of this Agreement is October 26, 1988.

United Health Care Benefit Trust

By

United Health Insurance Administrators

By

President U.A.S.B.

SCHEDULE 1- COMMISSION RATES (FOR AGENTS WITH LEADS & ADVANCES)

A. INDIVIDUAL POLICY FORMS AND COMMISSION

1-15 EMPLOYEES (FEW OWNERS)	1st yr. comm.	Renewal (2nd yr+) Comm.
a. Basic Hospital	52%	22%
b. Major Hospital	52%	22%
c. Comprehensive Hospital	52%	22%
d. Major Medical (in Hospital)	52%	22%
e. Major Medical (in & out of Hospital)	44%	22%
f. Dual Choice (PPO option Selected)	39%	22%
g. Bronze & Econo	39%	22%
h. Death Benefit (or Life Insurance)	26%	26%

B. GROUP POLICIES & COMMISSIONS (2 EMPLOYEES OR MORE)

Number of Employees	1st year comm.	Renewal (2nd yr +) Comm.
2-15	30%	26%
16-25	28%	26%
26-50	25%	26%
51-100	24%	24%
101-150	23%	23%
151-200	20%	20%
200+	19%	19%

Higher commissions paid for List Billing
See Above Conditions (See# A above)

United Healthcare Benefit Trust'

By

United Health Insurance Administrators

By

President U.A.S.B.

SCHEDULE II (FOR BROKERS (NO LEADS OR ADVANCES)

A. Individual Policy Commission 1-15 Employees	1st yr. Comm.	Renewal (2nd Yr)+ Comm.
1. Basic Hospital	59%	28%
2. Major Hospital	59%	28%
3. Comprehensive Hospital	59%	28%
4. Major Medical (in Hospital)	57%	28%
5. Major Medical (in & out of Hospital)	54%	28%
6. Dual Choice (PPO Option Selected)	42%	20%
7. Bronze & Econo	44%	28%
8. Death Benefit (or Life Insurance)	20%	28%

B. Group Policies & Commissions 6 Employees or more

Number of Employees	1st yr Comm.	Renewal (2nd yr) Comm.
6-15	32%	28%
Higher Commissions paid for 1ist Billing- see above conditions (see # A above)		
16-25	30%	28%
26-50	26%	26%
51-100	25%	25%
101-150	24%	24%
151-200	21%	21%
200+	20%	20%

Commissions Maybe adjusted or changed periodicaly by U.H.I.A.

United Healthcare Benefit Trust

X By

United Health Insurance Administrators

By Norman Bra

President U.A.S.B.

Schedule II A. Advances & Loans to Agents

Methods	Premiums Collected (plus $85 Set-Up fee)	one month's (% of premium)	Qualification
Method #1	1st three months prem. + $85.00	300%	Premiums paid by mo. Bank draft
Method #2	Quarterly Premiums + $85.00	290%	Quarterly Direct Billing
Method #3	1st two months prem. + $85,00	270%	Premiums Paid By Mo. Bank Draft
Method #4	1st one month prem. + $85.00	250%	Premiums paid by Mo. Bank Draft.
Method #5	Advances on Direct Billing semi-annual premiums are same as Method #4		
Method #6	Advances on Direct billing Annual Premmiums are same as Method #1		

Advances/loans maybe adjusted and changed periodicaly by U.H.I.A.

United Healthcare Benefit Trust

X By

United Health Insurance Administrators

By

President U.A.S.B.

Form **5500**
Department of the Treasury
Internal Revenue Service
Department of Labor
Pension and Welfare Benefits Administration
Pension Benefit Guaranty Corporation

Annual Return/Report of Employee Benefit Plan (With 100 or more participants)

This form is required to be filed under sections 104 and 4065 of the Employee Retirement Income Security Act of 1974 and sections 6039D, 6057(b), and 6058(a) of the Internal Revenue Code, referred to as the Code.

▶ **For Paperwork Reduction Act Notice, see page 1 of the instructions.**

OMB No 1210-0016

1988

This form is open to public inspection.

For the calendar plan year 1988 or fiscal plan year beginning June 01,1987 , 1987 and ending October 31, , 1988

If your plan year changed since the last return/report filed, check this box ▶ ☐

Type or print in ink all entries on the form, schedules, and attachments. If an item does not apply, enter "N/A." File the originals.

If *(i)* through *(iii)* do not apply to this year's return/report, leave the boxes unmarked. This return/report is:
(i) ☐ the first return/report filed for the plan, (ii) ☐ an amended return/report; or (iii) ☐ the final return/report filed for the plan.

▶ **Welfare benefit plans and fringe benefit plans need only complete certain items—see the instructions "What To File."**
▶ If you have been granted an extension of time to file this form, you must attach a copy of the approved extension to this form.

Use IRS label. Otherwise, please print or type.	1a Name of plan sponsor (employer if for a single-employer plan) Trustees of the Physicians & Hosp.Benefit Trust	1b Employer identification number 33 0196186
	Address (number and street) 911 Studebaker Road, Suite 250	1c Telephone number of sponsor (213) 598-6681
	City or town, state, and ZIP code Long Beach, CA 90802	1d Business code number
		1e CUSIP issuer number
2a	Name of plan administrator (if same as plan sponsor, enter "Same") Dual Plus Insurance Administrators	2b Administrator's employer identification no 33 0225676
	Address (number and street) 911 Studebaker Road, Suite 250	2c Telephone number of administrator (213) 598-6681
	City or town, state, and ZIP code Long Beach, CA 90815	

3 Are the name, address, and employer identification number (EIN) of the plan sponsor and/or plan administrator the same as they appeared on the last return/report filed for this plan? ☐ Yes ☐ No If "No," enter the information from the last return/report in a and/or b, and complete c.
a Sponsor ▶ .... EIN .... Plan number ......
b Administrator ▶ .... EIN ....
c If a indicates a change in the sponsor's name and EIN, is this a change in sponsorship only? (See specific instructions for definition of sponsorship.) ☐ Yes ☐ No

4 Check the appropriate box to indicate the type of plan entity (check only one box)
a ☐ Single-employer plan
b ☐ Plan of controlled group of corporations or common control employers
c ☒ Multiemployer plan
d ☐ Multiple employer-collectively bargained plan
e ☐ Multiple-employer plan (other)
f ☐ Group insurance arrangement (of welfare plans)

5a *(i)* Name of plan ▶ Physicians & Hospitals Benefit Trust
(ii) ☐ Check if name of plan changed since last return/report
5b Effective date of plan ▶ June,01,1987
5c Enter three-digit plan number ▶ 5 0 1

6a ☐ Welfare benefit plan (plan numbers 501 through 999) must check applicable items (A) through (P) and 6c.
(i) ☐ Type
(A) ☒ Health (other than dental or vision)
(B) ☐ Life insurance
(C) ☐ Supplemental unemployment
(D) ☐ Dental
(E) ☐ Vision
(F) ☐ Temporary disability (accident & sickness)
(G) ☐ Prepaid legal
(H) ☐ Long-term disability
(I) ☐ Severance pay
(J) ☐ Apprenticeship & training
(K) ☐ Scholarship (funded)
(L) ☐ Death benefits other than life insurance
(M) ☐ Code section 120 (group legal services plan)
(N) ☐ Code section 125 (cafeteria plan)
(O) ☐ Code section 127 (educational assistance program)
(P) ☐ Other (specify) ▶ ....
(ii) If you checked (M), (N), or (O), check if plan is: ☐ funded or ☐ unfunded

6b ☐ Pension benefit plan (plan numbers 001 through 500) must check applicable items in *(i)* through *(vii)* and answer 6c through 6l.
(i) ☐ Defined benefit plan
(ii) ☐ Defined contribution plan—(indicate type of defined contribution) (A) ☐ Profit-sharing (B) ☐ Stock bonus
(C) ☐ Target benefit (D) ☐ Other money purchase (E) ☐ Other (specify) ▶ ....
(iii) ☐ Defined benefit plan with benefits based partly on balance of separate account of participant (Code section 414(k))
(iv) ☐ Annuity arrangement of certain exempt organizations (Code section 403(b)(1))
(v) ☐ Custodial account for regulated investment company stock (Code section 403(b)(7))
(vi) ☐ Pension plan utilizing individual retirement accounts or annuities (described in Code section 408) as the sole funding vehicle for providing benefits
(vii) ☐ Other (specify) ▶

▶ Caution. A penalty for the late or incomplete filing of this return/report will be assessed unless reasonable cause is established.
Under penalties of perjury and other penalties set forth in the instructions, I declare that I have examined this return/report, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Date ▶ 2/1/87 Signature of employer/plan sponsor ▶
Date ▶ [illegible] Signature of plan administrator ▶

6c Other plan features: *(i)* ☐ ESOP *(ii)* ☐ Leveraged ESOP *(iii)* ☐ Participant-directed account plan
(iv) ☐ Pension plan maintained outside the United States *(v)* ☐ Master trust (see instructions)
(vi) ☐ 103-12 investment entity (see instructions) *(vii)* ☐ Common/collective trust *(viii)* ☐ Pooled separate account

		Yes	No
d	Single-employer plans enter the tax year end of the employer in which this plan year ends ▶ Month ...... Day ...... Year		
e	Is the employer a member of an affiliated service group?		X
f	Does this plan contain a cash or deferred arrangement described in Code section 401(k)?		X

7 Number of participants as of the end of the plan year (welfare plans complete only a(iv), b, c, and d)

a	Active participants: *(i)* Number fully vested	a(i)	
	(ii) Number partially vested	(ii)	
	(iii) Number nonvested	(iii)	
	(iv) Total	(iv)	
b	Retired or separated participants receiving benefits	b	
c	Retired or separated participants entitled to future benefits	c	
d	Subtotal (add a(iv), b, and c)	d	
e	Deceased participants whose beneficiaries are receiving or are entitled to receive benefits	e	
f	Total (add d and e)	f	

			Yes	No
g	*(i)* Was any participant(s) separated from service with a deferred vested benefit for which a Schedule SSA (Form 5500) is required to be attached to this form?	g(i)		X
	(ii) If "Yes," enter the number of separated participants required to be reported ▶			
8a	Were any plan amendments adopted during the plan year?	8a	X	
b	Did any amendment result in the retroactive reduction of accrued benefits for any participant?	b		X
c	Enter the date the most recent amendment was adopted ▶ Month .... Day .... Year			
d	If a is "Yes," did any amendment change the information contained in the latest summary plan descriptions or summary description of modifications available at the time of the amendment?	d		X
e	If d is "Yes," has a summary plan description or summary description of modifications that reflects the plan amendments referred to in d been furnished to participants and filed with the Department of Labor?	e	X	
9a	Was this plan terminated during this plan year or any prior plan year? If "Yes," enter the year ▶	9a		X
b	Were all plan assets either distributed to participants or beneficiaries, transferred to another plan, or brought under the control of PBGC?	b		X
c	Was a resolution to terminate this plan adopted during this plan year or any prior plan year?	c		X
d	If a or c is "Yes," have you received a favorable determination letter from IRS for the termination?	d		
e	If d is "No," has a determination letter been requested from IRS?	e		X
f	If a or c is "Yes," have participants and beneficiaries been notified of the termination or the proposed termination?	f		
g	If a is "Yes" and the plan is covered by PBGC, is the plan continuing to file a PBGC Form 1 and pay premiums until the end of the plan year in which assets are distributed or brought under the control of PBGC?	g		X
h	During this plan year, did any trust assets revert to the employer for which the Code section 4980 excise tax is due?	h		X
i	If h is "Yes," enter the amount of tax paid with your Form 5330 ▶			

10a In this plan year, was this plan merged or consolidated into another plan(s), or were assets or liabilities transferred to another plan(s)? ☐ Yes ☒ No

If "Yes," identify other plan(s)

b Name of plan(s) ▶	**c** Employer identification number(s)	**d** Plan number(s)

e Has Form 5310 been filed? ☐ Yes ☒ No

11 Enter the plan funding arrangement code (see instructions)	**12** Enter the plan benefit arrangement code (see instructions)
I	I

			Yes	No
13a	Is this a plan established or maintained pursuant to one or more collective bargaining agreements?	13a		X
b	If a is "Yes," enter the appropriate six-digit LM number(s) of the sponsoring labor organization(s) (see instructions): ▶ *(i)* *(ii)* *(iii)*			

14 If any benefits are provided by an insurance company, insurance service, or similar organization, enter the number of **Schedules A** (Form 5500), Insurance Information, that are attached. If none, enter "-0-." ▶ –0–

WELFARE PLANS DO NOT COMPLETE ITEMS 15 THROUGH 27. GO TO ITEM 28

Yes No

15a If this is a defined benefit plan, is it subject to the minimum funding standards for this plan year? 15a

If "Yes," attach **Schedule B** (Form 5500).

b If this is a defined contribution plan, i.e., money purchase or target benefit, is it subject to the minimum funding standards? (If a waiver was granted, see instructions.) . . . . b

If "Yes," complete *(i)*, *(ii)*, and *(iii)* below:

(i) Amount of employer contribution required for the plan year under Code section 412 b(i) $

(ii) Amount of contribution paid by the employer for the plan year . . . . . . b(ii) $

Enter date of last payment by employer ▶ Month .... Day .... Year.......

(iii) If *(i)* is greater than *(ii)*, subtract *(ii)* from *(i)* and enter the funding deficiency here; otherwise, enter zero. (If you have a funding deficiency, file Form 5330.) . b(iii) $

16 Has the plan been top-heavy at any time beginning with the 1984 plan year? 16

17 Has the plan accepted any transfers or rollovers with respect to a participant who had attained age 70½? 17

18a If the plan distributed any annuity contracts this year, did these contracts contain a requirement that the spouse consent before any distributions under the contract are made in a form other than a qualified joint and survivor annuity? 18a

b Did the plan make distributions to participants or spouses in a form other than a qualified joint and survivor annuity (a life annuity if a single person) or qualified preretirement survivor annuity (exclude deferred annuity contracts)? . . . . b

c Did the plan make distributions or loans to married participants and beneficiaries without the required consent of the participant's spouse? c

d Upon plan amendment or termination, do the accrued benefits of every participant include the subsidized benefits that the participant may become entitled to receive subsequent to the plan amendment or termination? . . . . d

19 Were the spousal consent requirements for distributions under Code section 417(e) complied with? 19

20 Have any contributions been made or benefits accrued in excess of the Code section 415 limits, as amended by the Tax Reform Act of 1986? 20

21 Has the plan made the required distributions in 1988 under Code section 401(a)(9)? 21

22a Does the plan satisfy the percentage test of Code section 410(b)(1)(A)? 22a

If **a** is "Yes," complete **b** through **i**. If "No," complete only **b** and **c** below and see specific instructions.

Number

b *(i)* Number of employees who are aggregated with employees of the employer as a result of the employer being aggregated with any employer covered by this plan under Code section 414(b), (c), or (m) . . . . . b(i)

(ii) Number of individuals who performed services as leased employees under Code section 414(n) including leased employees of employers in *(i)*. . . . . b(ii)

c Total number of employees (including any employees aggregated in **b**) c

d Number of employees excluded under the plan because of *(i)* minimum age or years of service, *(ii)* employees on whose behalf retirement benefits were the subject of collective bargaining, or *(iii)* nonresident aliens who receive no earned income from United States sources . . . . d

e Total number of employees not excluded (subtract **d** from **c**) . . . . e

f Employees ineligible (specify reason) ▶ .... f

g Employees eligible to participate (subtract **f** from **e**) . . . . g

h Employees eligible but not participating . . . . h

i Employees participating (subtract **h** from **g**) i

Yes No

23a Is it intended that this plan qualify under Code section 401(a)? 23a

If "Yes," complete **b** and **c**.

b Enter the date of the most recent IRS determination letter . . . . Month .... Year ....

c Is a determination letter request pending with IRS? c

24a If this is a plan with Employee Stock Ownership features, was a current appraisal of the value of the stock made immediately before any contribution of stock or the purchase of the stock by the trust for the plan year covered by this return/report? 24a

b If **a** is "Yes," was the appraisal made by an unrelated third party? . . . . b

25 Is this plan integrated with social security or railroad retirement? 25

26 Does the employer/sponsor listed in **1a** of this form maintain other qualified pension benefit plans? 26

If "Yes," enter the total number of plans, including this plan ▶

27 If this plan is an adoption of a master, prototype, or uniform plan, indicate which type by checking the appropriate box: **a** ☐ Master **b** ☐ Prototype **c** ☐ Uniform

		Yes	No
28a Did any person who rendered services to the plan receive directly or indirectly $5,000 or more in compensation from the plan during the plan year (except for employees of the plan who were paid less than $1,000 in each month)?	28a		
If "Yes," complete Part I of **Schedule C** (Form 5500).			
b Did the plan have any trustees who must be listed in Part II of Schedule C (Form 5500)?	b		
c Has there been a termination in the appointment of any person listed in **d** below?	c		
d If **c** is "Yes," check the appropriate box(es), answer **e** and **f**, and complete Part III of Schedule C (Form 5500): *(i)* ☐ Accountant *(ii)* ☐ Enrolled actuary *(iii)* ☐ Insurance carrier *(iv)* ☐ Custodian *(v)* ☐ Administrator *(vi)* ☐ Investment manager *(vii)* ☐ Trustee			
e Have there been any outstanding material disputes or matters of disagreement concerning the above termination?	e		
f If an accountant or enrolled actuary has been terminated during the plan year, has the terminated accountant/actuary been provided a copy of the explanation required by Part III of Schedule C (Form 5500) with a notice advising them of their opportunity to submit comments on the explanation directly to DOL?	f		
g Enter the number of Schedules C (Form 5500) that are attached. If none, enter -0- ▶			
29a Is this plan exempt from the requirement to engage an independent qualified public accountant?	29a		X
b If **a** is "No," attach the accountant's opinion to this return/report and check the appropriate box. This opinion is: *(i)* ☐ Unqualified *(ii)* ☐ Qualified/disclaimer per Department of Labor Regulations 29 CFR 2520.103-8 and/or 2520.103-12(d) *(iii)* ☐ Qualified/disclaimer other *(iv)* ☐ Adverse *(v)* ☒ Other (explain) Sec.CFR 2520,104-50 will be attached to next 5500			
c If **a** is "No," do the financial statements or notes to the financial statements attached to this return/report disclose *(i)* a loss contingency indicating that assets are impaired or liability incurred; *(ii)* significant real estate or other transactions in which the plan and (A) the sponsor, (B) plan administrator, (C) the employer(s), or (D) the employee organization(s) are jointly involved; *(iii)* that the plan has participated in any related party transactions; or, *(iv)* any unusual or infrequent events or transactions occurring subsequent to the plan year-end that might significantly affect the usefulness of the financial statements in assessing the plan's present or future ability to pay benefits?	c		X
d If **c** is "Yes," provide the total amount involved in such disclosure ▶			
30 If **29a** is "No," during the plan year:			
a Did the plan have assets held for investment?	30a		X
b Were any loans by the plan or fixed income obligations due the plan in default as of the close of the plan year or classified during the year as uncollectible?	b		X
c Were any leases to which the plan was a party in default or classified during the year as uncollectible?	c		X
d Were any plan transactions or series of transactions in excess of 5% of the current value of plan assets?	d		X
e Do the notes to the financial statements accompanying the accountant's opinion disclose any nonexempt transactions with parties-in-interest?	e		
f Did the plan engage in any nonexempt transactions with parties-in-interest not reported in **e**?	f		X
g Did the plan hold qualifying employer securities that are not publicly traded?	g		X
h Did the plan purchase or receive any nonpublicly traded securities that were not appraised in writing by an unrelated third party within 3 months prior to their receipt?	h		X
i Did any person manage plan assets who had a financial interest worth more than 10% in any party providing services to the plan or receive anything of value from any party providing services to the plan?	i		X
If **a**, **b**, **c**, **d**, **e**, or **f** is checked "Yes," schedules of those items in the format set forth in the instructions are required to be attached to this return/report			
31 Did the plan acquire individual whole life insurance contracts during the plan year?	31		X
32 During the plan year:			
a *(i)* Was this plan covered by a fidelity bond? Administrators	32a	X	
(ii) If (i) is "Yes," enter amount of bond ▶ $5,000 Western Surety (per occurance)			
b *(i)* Was there any loss to the plan, whether or not reimbursed, caused by fraud or dishonesty?	b		X
(ii) If (i) is "Yes," enter amount of loss ▶			

33a Is the plan covered under the Pension Benefit Guaranty Corporation termination insurance program?

☐ Yes ☐ No ☐ Not determined

b If **a** is "Yes" or "Not determined," enter the employer identification number and the plan number used to identify it.

Employer identification number ▶ Plan number ▶

34 Current value of plan assets and liabilities at the beginning and end of the plan year. Combine the value of plan assets held in more than one trust. Allocate the value of the plan's interest in a commingled trust containing the assets of more than one plan on a line-by-line basis unless the trust meets one of the specific exceptions described in the instructions. Do not enter the value of that portion of an insurance contract which guarantees, during this plan year, to pay a specific dollar benefit at a future date. **Round off amounts to the nearest dollar.** Plans with no assets at the beginning and the end of the plan year, enter zero on line 34f.

		(a) Beginning of year	(b) End of Year
Assets			
a Total noninterest-bearing cash	a	21,537	70,873
b Receivables (net):			
(i) Employer contributions	b(i)		249,000
(ii) Participant contributions	(ii)		
(iii) Income	(iii)		21,436
(iv) Other	(iv)		65,739
(v) Total	(v)		407,048
c General investments:			
(i) Interest-bearing cash (including money market funds)	c(i)	-0-	
(ii) Certificates of deposit	(ii)		
(iii) U.S. Government securities	(iii)		
(iv) Corporate debt instruments	(iv)		
(v) Corporate stocks:			
(A) Preferred	(v)(A)		
(B) Common	(B)		
(vi) Partnership/joint venture interests	(vi)		
(vii) Real estate:			
(A) Income-producing	(vii)(A)		
(B) Nonincome-producing	(B)		
(viii) Loans (other than to participants) secured by mortgages:			
(A) Residential	(viii)(A)		
(B) Commercial	(B)		
(ix) Loans to participants:			
(A) Mortgages	(ix)(A)		
(B) Other . . . Name & Contracts	(B)	-0-	52,500
(x) Other loans	(x)		
(xi) Value of interest in certain investment arrangements (see instructions)	(xi)		
(xii) Value of funds held in insurance company general account (unallocated contracts)	(xii)		500,00
(xiii) Other PPO, Contracts w/Administrator	(xiii)		
(xiv) Total	(xiv)		
d Employer-related investments:			
(i) Employer securities	d(i)		
(ii) Employer real property	(ii)		
e Buildings and other property used in plan operation Inventory, Equipment, Leasehold Improvements	e	-0-	52,734
f Total assets	f	-0-	1,812,526
Liabilities			
g Benefit claims payable	g	-0-	185,259
h Operating payables	h	-0-	
i Acquisition indebtedness	i		
j Other liabilities	j		
k Total liabilities	k		185,259
Net Assets			
l Line f minus line k	l	21,537	1,627,267

35 Plan income, expenses, and changes in net assets for the plan year.
Include all income and expenses of the plan, including any trust(s) or separately maintained fund(s), and any payments/receipts to/from insurance carriers. **Round off amounts to the nearest dollar.**

Income		(a) Amount	(b) Total
a Contributions:			
(i) Received or receivable from:			
(A) Employers	a(i)(A)	3,762,628	
(B) Participants	(B)	-0-	
(C) Others	(C)	-0-	
(ii) Noncash contributions	(ii)		3,762,628
b Earnings on investments:			
(i) Interest:			
(A) Interest-bearing cash (including money market funds)	b(i)(A)	2,093	
(B) Certificates of deposit	(B)	-0-	
(C) U.S. Government securities	(C)	-0-	
(D) Corporate debt instruments	(D)	-0-	
(E) Mortgage loans	(E)	-0-	
(F) Other loans	(F)	-0-	
(G) Other	(G)	-0-	2,093
(ii) Dividends:			
(A) Preferred stock	b(ii)(A)	-0-	
(B) Common stock	(B)	-0-	-0-
(iii) Rents	(iii)		-0-
(iv) Net gain (loss) on sale of assets:			
(A) Aggregate proceeds	b(iv)(A)	-0-	
(B) Aggregate costs	(B)	-0-	-0-
(v) Unrealized appreciation (depreciation) of assets	(v)		-0-
(vi) Net investment gain (loss) from certain investment arrangements—see instructions	(vi)		-0-
c Other income	c		
d Total income (add **a**, **b**, and **c**)	d		3,764,721
Expenses			
e Benefit payment and payments to provide benefits:			
(i) Directly to participants or beneficiaries	e(i)	-0-	
(ii) To insurance carriers for the provision of benefits Excess Loss Ins.	(ii)	277,744	
(iii) Other	(iii)	2,259,204	
f Interest expense	f		
g Administrative expenses:			
(i) Salaries and allowances	g(i)	-0-	
(ii) Accounting fees	(ii)		
(iii) Actuarial fees	(iii)		
(iv) Contract administrator fees	(iv)	1,115,000	
(v) Investment advisory and management fees	(v)		
(vi) Legal fees	(vi)		
(vii) Valuation/appraisal fees	(vii)		
(viii) Trustees fees/expenses (including travel, seminars, meetings, etc.)	(viii)		
(ix) Other Name, Furniture, Equipment, Bank Chgs, Etc.	(ix)	63,437	
h Total expenses (add **e**, **f**, and **g**)	h		3,715,385
i Net income (loss) (**d** minus **h**)	i		49,336
j Transfers to (from) the plan (see instructions)	j		
k Net assets at beginning of year (line 34l, column (a))	k		-0-
l Net assets at end of year (line 34l, column (b))	l		49,336

	Yes	No
36 Did any employer sponsoring the plan pay any of the administrative expenses of the plan that were not reported in 35g?		

Accounting Notes

Analysis of the entire year of 1988

1. Paid loss ratio:

   1988 Paid Claims - $ 1,828,405
   1988 Premium - $ 2,749,758 = 66.5%

2. Unpaid Claims (those being adjudicated or pending awaiting medical records) are projected to be, after adjudication) - $222,509 or an amount equal to only 53.6% of current monthly premium.

3. Loss Analysis

   a) Excess loss re-insurance coverage (United National)

      1) Specific Coverage: $962,500 in excess of $37,500
      2) Aggregate Coverage: Excess of $110 per employee per month incurred and paid in 12 months

   b) Current Status

      Aggregate attachment $110 = 67%
      current average Prem/Emp. $163.98
      i.e. aggregate losses in excess of 67% of Premiums are fully insured.

      Current losses as a precent of premium.

      1988 Paid Claims = $1,828,405 = $1152/year
      # Emp. end 1988 1586

      or $96.07 ave. claim per Emp/month = 56% of current ave. prem.

      Adding unpaid claims ($222,509) = $107.76 ave. per Emp/month

      = 66% of current ave. prem.

      Adding IBNR

      (ave. daily adjudicated claim volume x ave. "lag time"

      x 120% margin) =

      $5577 x 35 days x 120% = $234,254

      or $107.76 per Emp/month Total expected claims cost

      = 72% of current premium

4. Cost Containment

The Plan is a tightly controlled managed care P.P.O. system with emphasis on strict underwriting guidelines and rigorous claims adjudication.

Claims after adjudication, audit and adjustment to Provider contract rates average approximately 54% paid on the billed amount. This percentage has been consistent throughout the history of the Trust.

5. Trending

Average employee premium at beginning of 1988 was $131.01.

Current average employee premium is $163.98, an increase of 25% over the past year.

The Trust anticipates between an 18% - 20% trending factor for 1989. Rates will increase proportionately in May, 1989.

6. Administration

Total administration costs and all operating expenses are averaging 28% of premium and are progressively decreasing. Included are all brokerage commissions which are averaging 8% of premium. An increasing number of partially self-funded accounts are enrolling into the Trust.

7. Loss Contingency

Assest are not impaired.

No other liabilities incurred.

No significant real estate or other Transactions of any kind are involved.

No related party Transactions have been participated in.

No other infrequent events or Transactions have occurred.

BALANCE SHEET
for
Physicians and Hospitals Benefits Trust
Dual-Plus Insurance Administrators
for the 12 months ending January 1, 1989

Assets			
Current Assets			
Cash Reserves	$ 203,118		
Accounts Receivable-Premium (current)	304,289		
Accounts Rec'v-Re-Insurance	65,739		
Accounts Receivable-Other	21,436		
Total current assets		$ 594,582	
Fixed Assets			
Inventory	13,200		
Equipment & Furnishings	39,544		
Total Fixed Assets		$ 52,734	
Other Assets			
Name purchase, Trade Contracts	52,500		
P.P.O. Network	500,000		
Total Other Assets		$ 525,500	
Total Assets			$ 1,172,816
Liabilities			
Claims Pending	222,509		
Total Liabilities		$ 222,509	
Equity			
Retained Earnings	57,526		
Net Income	140,364		
Equity	420,398		
Total Equity		$ 618,389	
Total Liability & Equity			$ 1,172,816

COMBINED INCOME STATEMENT
for
Physicians and Hospitals Benefits Trust
Dual-Plus Insurance Administrators
for the 12 months ending January 1, 1989

Income		
Premium Income	$ 2,749,758	
Panel Services	9,169	
Premium Refund	(22,087)	
Investment Income	2,083	
Total Income		$ 2,738,923
Expenses		
Operating Expenses		
Claims - Medical inc. Reins.	1,828,405	
Total Operating expenses		$ 1,828,405
Administration Expenses		
Employee Expense		
Travel	395	
Auto Expense	6,337	
Auto Leasing	9,878	
Entertainment	1,709	
Advertising	802	
Moving Expense	10,461	
Workman's Compensation	3,136	
Medical Insurance	7,532	
Miscellaneous Insurance	3,185	
Dues, Subscriptions, licenses	1,129	
Payroll	173,756	
Total Employee Expenses		$ 218,320
Office Expenses		
Rent	126,028	
Supplies	10,509	
Telephone	17,701	
Postage	10,650	
Warehouse	1,171	
Equipment Repair	2,969	
Equipment Lease	6,197	
Miscellaneous	2,030	
Total Office Expenses		$ 177,252
Professional Services		
Commissions	223,403	
Computer Services	111,024	
Printing	13,684	
Delivery	2,720	

CLAIMS SUMMARY Feb. 28 '89
PHBT COMBINED SELF-FUNDED & NON-SELF-SUNDED

		1988	1989				
	FROM BEGINING TO DATE	YEAR TO DATE	YEAR TO DATE	FEBRUARY '89	JANUARY '89	DECEMBER '88	NOVEMBER '88
TOTAL NET PREMIUM	4,264,979.30	2,749,758.11	144,464.06	414,773.15	365,517.16	261,414.52	304,897.90
TOTAL NEW PREMIUM				35,301.00	58,228.96	4,626.57	12,770.89
TOTAL S-FUNDED PREMIUM	108,241.45		108,241.45	60,376.15	47,865.30		
TOT NEW S-FUNDED PREM				3,068.80			
TOTAL ACTIVE GROUPS	579	424	86	579	545	537	528
TOTAL # NEW GROUPS				47	39	20	44
TOTAL LIVES	4503	2752	1516	4503	4138	3311	3511
TOTAL # NEW LIVES				537	979	63	170
TOTAL EMPLOYEES	2599	1596	981	2599	2380	2000	2000
TOTAL # NEW EMPLOYEES				289	592	27	90
TOTAL DEPT. LIVES	1904	1166	635	1904	1758	1311	1511
TOTAL # NEW DEPT. LIVES				248	387	36	80
AVE. GROUP PREM. AMT.	631.29	438.36	1,679.81	751.09	1,585.25	231.33	290.25
AVE. GROUP SIZE	7.9	6.5	17.6	11.4	25.1	3.1	3.9
AVE. PREM. PER EMP.	140.64	129.99	163.98	132.77	185.10	171.35	141.90
AVE. PREM. PER MEMBER	81.17	67.41	95.29	71.45	112.04	73.44	75.12
TOTAL # CLMS REC'D	21003	12742	2879	1269	1610	1061	992
TOTAL OF CLMS REC'D	5,953,451.00	3,769,966.00	867,954.00	416,341.00	451,913.00	269,232.00	362,064.00
PHYSICIANS	3,384,357.00 0.57	2,154,211.00 0.57	436,513.00 0.50	206,159.00 0.50	230,354.00 0.51	164,178.00 0.61	183,521.00 0.51
HOSPITAL	2,295,483.00 0.39	1,464,399.00 0.39	376,408.00 0.43	191,051.00 0.46	185,357.00 0.41	102,903.00 0.38	174,755.00 0.48
PHARMACY	172,139.00 0.03	91,519.00 0.02	47,293.00 0.05	15,367.00 0.04	31,926.00 0.07	(47.00)*.00)	627.00 0.00
CHIROPRAC	57,809.00 0.01	33,404.00 0.01	2,645.00 0.00	1,510.00 0.00	1,135.00 0.00	952.00 0.00	1,894.00 0.01
PODIATRY	28,462.00 0.00	17,066.00 0.00	3,339.00 0.00	1,150.00 0.00	2,199.00 0.00	860.00 0.00	492.00 0.00
OPTOMITRY	15,205.00 0.00	9,268.00 0.00	1,739.00 0.00	809.00 0.00	930.00 0.00	385.00 0.00	777.00 0.00
AVE $ OF TOT CLMS REC'D	283.46	295.87	301.48	327.85	280.69	253.75	364.98
AVE $ CLMS PER PERSON	1,322.11	911.06	192.75	92.39	109.21	81.31	103.12
AVE $ AMT CLMS PER FAM.	2,290.67	1,584.02	333.96	160.08	189.88	134.62	181.03
TOTAL # CLMS PD	20173	11634	3124	1254	1870	673	1216
TOTAL # CLMS UNPAID	880	1108	-245	15	-260	388	-224
AVE # CLMS PER PERSON	4.66	4.63	0.67	0.29	0.39	0.32	0.28
AVE # CLMS PER FAMILY	11.03	8.03	1.17	0.49	0.68	0.53	0.50
TOTAL AMT OF CLMS PD	3,040,560.00 0.55	1,829,405.00 0.54	440,071.00 0.54	223,190.00 0.56	216,891.00 0.53	112,951.00 0.45	228,434.00 0.61
TOTAL AMT OF CLMS ADJUD	5,547,483.00	3,393,086.00	812,776.00	401,184.00	411,592.00	250,737.00	372,400.00
PHYSICIANS	3,166,326.00 0.57	1,935,380.00 0.57	445,836.00 0.55	190,577.00 0.48	255,259.00 0.62	128,026.00 0.51	220,211.00 0.59
HOSPITAL	2,119,089.00 0.38	1,311,665.00 0.39	312,592.00 0.38	193,231.00 0.48	119,361.00 0.29	121,935.00 0.49	147,006.00 0.39
PHARMACY	171,859.00 0.05	90,698.00 0.05	47,529.00 0.11	15,357.00 0.08	32,172.00 0.13	(272.00)*.00)	1,003.00 0.00
CHIROPRAC	49,112.00 0.02	31,457.00 0.02	2,141.00 0.00	530.00 0.00	1,611.00 0.01	284.00 0.00	1,869.00 0.01
PODIATRY	26,219.00 0.01	13,419.00 0.01	2,955.00 0.01	561.00 0.00	2,294.00 0.01	240.00 0.00	1,457.00 0.01
OPTOMITRY	14,880.00 0.00	8,468.00 0.00	1,724.00 0.00	930.00 0.00	894.00 0.00	525.00 0.00	854.00 0.00
AVE # DAYS INC TO REC'D	35	35	35	35	35	35	35
TOTAL $ CLMS REC'D UNPD	405,968.00	376,880.00	55,178.00	14,857.00	40,321.00	18,495.00	(10,336.00)
PROJ UNPD CLMS (NET)	222,509.93	203,086.30	29,875.68	8,265.00	21,247.41	3,724.18	(6,340.21)
CLMS PAID PREM PERCENT	0.713	0.665	0.564	0.538	0.683	0.432	0.749
PROJ LOSS RATIO PERCENT	0.765	0.739	0.502	0.558	0.750	0.464	0.728
TOTAL # OLD CLMS TO PD.	0.548	0.539	0.541	0.556	0.527	0.450	0.613

Accounting Notes

Analysis of the entire year of 1988

1. Paid loss ratio:

$$\frac{\text{1988 Paid Claims - \$ 1,828,405}}{\text{1988 Premium - \$ 2,749,758}} = 66.5\%$$

2. Unpaid Claims (those being adjudicated or pending awaiting medical records) are projected to be, after adjudication) - $222,509 or an amount equal to only 53.6% of current monthly premium.

3. Loss Analysis

   a) Excess loss re-insurance coverage (United National)

      1) Specific Coverage: $962,500 in excess of $37,500
      2) Aggregate Coverage: Excess of $110 per employee per month incurred and paid in 12 months

   b) Current Status

$$\frac{\text{Aggregate attachment}}{\text{current average Prem/Emp.}} \quad \frac{\$110}{\$163.98} = 67\%$$

i.e. aggregate losses in excess of 67% of Premiums are fully insured.

Current losses as a precent of premium.

$$\frac{\text{1988 Paid Claims}}{\text{\# Emp. end 1988}} = \frac{\$1,828,405}{1586} = \$1152/\text{year}$$

or $96.07 ave. claim per Emp/month = 56% of current ave. prem.

Adding unpaid claims ($222,509) = $107.76 ave. per Emp/month

= 66% of current ave. prem.

Adding IBNR

(ave. daily adjudicated claim volume x ave. "lag time"

x 120% margin) =

$5577 x 35 days x 120% = $234,254

or $107.76 per Emp/month Total expected claims cost

= 72% of current premium

4. Cost Containment

The Plan is a tightly controlled managed care P.P.O. system with emphasis on strict underwriting guidelines and rigorous claims adjudication.

Claims after adjudication, audit and adjustment to Provider contract rates average approximately 54% paid on the billed amount. This percentage has been consistent throughout the history of the Trust.

5. Trending

Average employee premium at beginning of 1988 was $131.01.

Current average employee premium is $163.98, an increase of 25% over the past year.

The Trust anticipates between an 18% - 20% trending factor for 1989. Rates will increase proportionately in May, 1989.

6. Administration

Total administration costs and all operating expenses are averaging 28% of premium and are progressively decreasing. Included are all brokerage commissions which are averaging 8% of premium. An increasing number of partially self-funded accounts are enrolling into the Trust.

7. Loss Contingency

Assest are not impaired.

No other liabilities incurred.

No significant real estate or other Transactions of any kind are involved.

No related party Transactions have been participated in.

No other infrequent events or Transactions have occurred.

Form

Department of the Treasury
Internal Revenue Service

Department of Labor
Pension and Welfare Benefits Administration

Pension Benefit Guaranty Corporation

(With 100 or more participants)

This form is required to be filed under sections 104 and 4065 of the Employee Retirement Income Security Act of 1974 and sections 6039D, 6057(b) and 6058(a) of the Internal Revenue Code, referred to as the Code.

► **For Paperwork Reduction Act Notice, see page 1 of the instructions.**

1987

This form is open to public inspection.

For the calendar plan year 1987 or fiscal plan year beginning August 1, 1987, and ending July 31, 1988

Type or print in ink all entries on the form, schedules, and attachments. If an item does not apply, enter "N/A." File the originals.

If *(i)* through *(iii)* do not apply to this year's return/report, leave the boxes unmarked. This return/report is:

(i) ☐ the first return/report filed for the plan; *(ii)* ☐ an amended return/report; or *(iii)* ☐ the final return/report filed for the plan.

► Welfare benefit plans, including those described in Code section 6039D, need only complete certain items—see the instructions "What To File."

► Keogh (H.R. 10) plans must check the box in item 5a(iii).

► If you have been granted an extension of time to file this form, you must attach a copy of the approved extension to this form.

Check this box if an extension of time to file this return is attached ► ☐

Use IRS label. Otherwise, please print or type.	1a Name of plan sponsor (employer if for a single-employer plan) National Business Association Trust	1b Employer identification number 61 ⁝ 6141156
	Address (number and street) 332 W. Broadway - Suire 700	1c Telephone number of sponsor (502) 589-6772
	City or town, state, and ZIP code Louisville, KY 40202	1d If plan year changed since last return/report, check here . . . ► ☐
	2a Name of plan administrator (if same as plan sponsor, enter "Same") Same	1e Business code number ►
	Address (number and street)	2b Administrator's employer identification no.
	City or town, state, and ZIP code	2c Telephone number of administrator ( )

3 Is the name, address, and employer identification number (EIN) of the plan sponsor and/or plan administrator the same as they appeared on the last return/report filed for this plan? ☐ Yes ☒ No. If "No," enter the information from the last return/report in a and/or b.

a Sponsor ► Mid-America Soft Drink Bottling Trust EIN 61-6141156

b Administrator ► Same EIN

c If a indicates a change in the sponsor's name and EIN, is this a change in sponsorship only? (See specific instructions for definition of sponsorship.) ☒ Yes ☐ No

4 Check appropriate box to indicate the type of plan entity (check only one box):

a ☐ Single-employer plan
b ☐ Plan of controlled group of corporations or common control employers
c ☐ Multiemployer plan
d ☐ Multiple-employer-collectively-bargained plan
e ☒ Multiple-employer plan (other)
f ☐ Group insurance arrangement (of welfare plans)

5a *(i)* Name of plan ► National Business Association Trust

(ii) ☒ Check if name of plan changed since last return/report

(iii) ☐ Check this box if this is a Keogh (H.R. 10) plan.

5b Effective date of plan 8/1/82

5c Enter three-digit plan number . . ► 5 0 1

6a Welfare benefit plan (Plan numbers 501 through 999) must complete (i) through (vii) and 6c:

(i) ☒ Health insurance *(ii)* ☒ Life insurance *(iii)* ☐ Supplemental unemployment

(iv) ☒ Other (specify) ► Weekly Disability and Vision Care

(v) ☐ Code section 120 (group legal services plan) *(vi)* ☐ Code section 125 (cafeteria plan)

(vii) ☐ Code section 127 (educational assistance program)

If you checked (v), (vi), or (vii) check if: ☐ funded or ☐ unfunded.

b Pension benefit plan (Plan numbers 001 through 500) must complete (i) through (vii) and 6c through 6f:

(i) Defined benefit plan—(Indicate type of defined benefit plan): (A) ☐ Fixed benefit (B) ☐ Unit benefit (C) ☐ Flat benefit (D) ☐ Other (specify) ►

(ii) Defined contribution plan—(indicate type of defined contribution): (A) ☐ Profit-sharing (B) ☐ Stock bonus (C) ☐ Target benefit (D) ☐ Other money purchase (E) ☐ Other (specify) ►

(iii) ☐ Defined benefit plan with benefits based partly on balance of separate account of participant (Code section 414(k))

(iv) ☐ Annuity arrangement of certain exempt organizations (Code section 403(b)(1))

(v) ☐ Custodial account for regulated investment company stock (Code section 403(b)(7))

(vi) ☐ Pension plan utilizing individual retirement accounts or annuities (described in Code section 408) as the sole funding vehicle for providing benefits

(vii) ☐ Other (specify) ►

Under penalties of perjury and other penalties set forth in the instructions, I declare that I have examined this return/report, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Date ► 1-23-89 Signature of employer/plan sponsor ► Executive Director

Date ► Signature of plan administrator ►

6c Other plan features: *(i)* ☐ Thrift-savings *(ii)* ☐ Participant-directed account plan *(iii)* ☐ Pension plan maintained outside the United States

(iv) ☐ Master trust (see instructions) ▶ ....

(v) ☐ 103-12 investment entity (see instructions) ▶ ....

d Single-employer plans enter the tax year end of the employer in which this plan year ends ▶ Month ...... Day ...... Year ......

e Is the employer a member of an affiliated service group?

f Does this plan contain a cash or deferred arrangement described in Code section 401(k)?

	Yes	No
d		
e		
f		

7 Number of participants as of the end of the plan year (welfare plans complete only a(iv), b, c, and d):

a Active participants: *(i)* Number fully vested

(ii) Number partially vested

(iii) Number nonvested

(iv) Total

b Retired or separated participants receiving benefits

c Retired or separated participants entitled to future benefits

d Subtotal (add a(iv), b, and c)

e Deceased participants whose beneficiaries are receiving or are entitled to receive benefits

f Total (add d and e)

a(i)	
(ii)	
(iii)	
(iv)	16,523
b	0
c	0
d	16,623
e	
f	

g *(i)* Was any participant(s) separated from service with a deferred vested benefit for which a Schedule SSA (Form 5500) is required to be attached to this form?

(ii) If "Yes," enter the number of separated participants required to be reported ▶

8 Plan information—You must complete a, c, d

a Was any amendment to this plan adopted in this plan year?

b If "Yes," *(i)* And if any amendments have resulted in a change in the information contained in a summary plan description or previously furnished summary description of modifications—

(A) Have summary descriptions of the change(s) been sent to participants?

(B) Have summary descriptions of the change(s) been filed with DOL?

(ii) Does any amendment result in the reduction of the accrued benefit of any participant under the plan?

c Enter the date the most recent amendment was adopted ▶ Month 7 Day 31 Year 88

d *(i)* Has a summary plan description been filed with DOL for this plan?

(ii) If (i) is "Yes," what was the employer identification number and the plan number used to identify it?

Employer identification number ▶ 616141156 Plan number ▶ 501

	Yes	No
g(i)		X
8a	X	
b(i)A	X	
(i)B	X	
(ii)		X
d	X	

9a Was this plan terminated during this plan year or any prior plan year? If "Yes," enter year ▶ ....

b Were all plan assets either distributed to participants or beneficiaries, transferred to another plan, or brought under the control of PBGC?

c Was a resolution to terminate this plan adopted during this plan year or any prior plan year?

d If a or c is "Yes," have you received a favorable determination letter from IRS for the termination?

e If d is "No," has a determination letter been requested from IRS?

f If a or c is "Yes," have participants and beneficiaries been notified of the termination or the proposed termination?

g If a is "Yes," and the plan is covered by PBGC, is the plan continuing to file a PBGC Form 1 and pay premiums until the end of the plan year in which assets are distributed or brought under the control of PBGC?

h During this plan year, did any trust assets revert to the employer for which the Code section 4980 excise tax is due?

i If h is "Yes," enter the amount of section 4980 tax paid with your Form 5330 ▶

	Yes	No
9a		X
b		
c		X
d		
e		
f		
g		
h		
10a		X

10a In this plan year, was this plan merged or consolidated into another plan(s), or were assets or liabilities transferred to another plan(s)? If "Yes," identify other plan(s):

b Name of plan(s)	c Employer identification number(s)	d Plan number(s)
▶		

e Has Form 5310 been filed? ☐ Yes ☐ No

11 Indicate a funding arrangement in a through e and complete f if applicable: a ☐ Trust (benefits provided in whole from trust funds)

b ☒ Trust or arrangement providing benefits partially through insurance and/or annuity contracts

c ☐ Trust or arrangement providing benefits exclusively through insurance and/or annuity contracts

d ☐ Custodial account described in Code section 401(f) and not included in c above

e ☐ Other (specify) ▶ ....

f If b or c is checked, enter the number of Schedules A (Form 5500) which are attached ▶

12a Has the plan used the services of a contract administrator (see instructions)? ☒ Yes ☐ No

If "Yes," you must complete line (1) of the schedule below.

b Did any other person who rendered services to the plan receive, directly or indirectly, compensation from the plan in the plan year? ☒ Yes ☐ No

If "Yes," furnish the following information starting on line (2):

(a) Name	(b) Employer identification number (see instructions)	(c) Official plan position	(d) Relationship to employer, employee organization, or person known to be a party-in-interest	(e) Gross salary or allowances paid by plan	(f) Fees and commissions paid by plan	(g) Nature of service code (see instructions)
		Contract admin.				
(1) See attached						
(2) schedule						
(3)						

13 Plan assets and liabilities at the beginning and the end of the plan year (list all assets and liabilities at current value). A fully insure welfare plan or a pension plan with no trust and which is funded entirely by allocated insurance contracts which fully guarantee th amount of benefit payments should check the box and not complete the rest of this item ▶

Note: *Include all plan assets and liabilities of a trust or separately maintained fund. (If more than one trust/fund, report on a combined basis.) Include insurance values except for the value of that portion of an allocated insurance contract which fully guarantees the amount of benefit paymen Round off amounts to the nearest dollar. Trusts with no assets at the beginning and the end of the plan year enter zero on line 13h.*

Assets		(a) Beginning of year	(b) End of year
a Cash: *(i)* On hand	a(i)		
(ii) In bank: (A) Certificates of deposit	(ii)(A)		
(B) Other interest bearing	(ii)(B)	54,899	
(C) Noninterest bearing	(ii)(C)		
(iii) Total cash (add (i) and (ii))	(iii)		
b Receivables: *(i)* Employer contributions	b(i)		445,216
(ii) Employee contributions	(ii)		
(iii) Other	(iii)	105,795	98,587
(iv) Reserve for doubtful accounts	(iv)		
(v) Net receivables (subtract (iv) from the total of (i), (ii), and (iii))	(v)	105,795	543,803
c General investments other than party-in-interest investments:			
(i) U.S. Government securities: (A) Long term	c(i)(A)		
(B) Short term	(i)(B)		
(ii) State and municipal securities	(ii)		
(iii) Corporate debt instruments: (A) Long term	(iii)(A)		
(B) Short term	(iii)(B)		
(iv) Corporate stocks: (A) Preferred	(iv)(A)		
(B) Common	(iv)(B)		
(v) Shares of a registered investment company	(v)		
(vi) Real estate	(vi)		
(vii) Mortgages	(vii)		
(viii) Loans other than mortgages	(viii)		
(ix) Value of interest in pooled fund(s)	(ix)		
(x) Value of interest in master trust	(x)		
(xi) Value of interest in 103-12 investment entities	(xi)		
(xii) Other investments	(xii)		
(xiii) Total general investments (add (i) through (xii))	(xiii)		
d Party-in-interest investments:			
(i) Corporate debt instruments	d(i)		
(ii) Corporate stocks: (A) Preferred	(ii)(A)		
(B) Common	(ii)(B)		
(iii) Real estate	(iii)		
(iv) Mortgages	(iv)		
(v) Loans other than mortgages	(v)		
(vi) Other investments	(vi)		
(vii) Total party-in-interest investments (add (i) through (vi))	(vii)		
e Buildings and other depreciable property used in plan operation	e		
f Value of unallocated insurance contracts (other than pooled separate accounts):			
(i) Separate accounts	f(i)		
(ii) Other	(ii)		
(iii) Total (add (i) and (ii))	(iii)		
g Other assets	g		
h Total assets (add a(iii), b(v), c(xiii), d(vii), e, f(iii), and g)	h	160,694	543,803
Liabilities			
i Payables: *(i)* Plan claims	i(i)		858,875
(ii) Other payables	(ii)		251,415
(iii) Total payables (add (i) and (ii))	(iii)		1,110,290
j Acquisition indebtedness	j		
k Other liabilities Prepaid Premiums	k		220,890
l Total liabilities (add i, j, and k)	l		1,331,180
m Net assets (subtract l from h)	m	160,694	- 787,377

n During the plan year what were the:		
(i) Total costs of acquisitions of common stock?	n(i)	0
(ii) Total proceeds from dispositions of common stock?	(ii)	0

14 Plan income, expenses and changes in net assets for the plan year.

Note: *Include all income and expenses of a trust(s) or separately maintained fund(s) including any payments made for allocated insurance contracts. Round off amounts to nearest dollar.*

Income		(a) Amount	(b) Total
a Contributions received or receivable in cash from—			
(i) Employer(s) (including contributions on behalf of self-employed individuals)	a(i)	13,553,618	
(ii) Employees	(ii)		
(iii) Others	(iii)		13,553,618
b Noncash contributions (specify nature and by whom made) ▶	b		
c Total contributions (add total of a(iii) and b)	c		13,553,618
d Earnings from investments—			
(i) Interest	d(i)	7,599	
(ii) Dividends	(ii)		
(iii) Rents	(iii)		
(iv) Royalties	(iv)		7,599
e Net realized gain (loss) on sale or exchange of assets—			
(i) Aggregate proceeds	e(i)		
(ii) Aggregate costs	(ii)		
f Other income (specify) ▶	f		
g Total income (add c through f)	g		13,561,217
Expenses		**(a) Amount**	**(b) Total**
h Distribution of benefits and payments to provide benefits—			
(i) Directly to participants or their beneficiaries	h(i)	10,537,477	
(ii) To insurance carrier or similar organization for provision of benefits	(ii)		
(iii) To other organizations or individuals providing welfare benefits	(iii)		10,537,477
i Interest expense	i		
j Administrative expenses—			
(i) Salaries and allowances	j(i)		
(ii) Fees and commissions	(ii)	2,527,124	
(iii) Insurance premiums for Pension Benefit Guaranty Corporation	(iii)		
(iv) Insurance premiums for fiduciary insurance other than bonding	(iv)		
(v) Other administrative expenses	(v)	72,806	2,599,930
k Other expenses (specify) ▶ Stop-Loss Coverage & Life Coverage	k		1,371,881
l Total expenses (add h through k)	l		14,509,288
m Net income (expenses) (subtract l from g)	m		- 948,071
		(a) Amount	**(b) Total**
n Changes in net assets —			
(i) Unrealized appreciation (depreciation) of assets	n(i)		
(ii) Net investment gain (loss) from all master trust investment accounts	(ii)		
(iii) Net investment gain (loss) from all 103-12 investment entities	(iii)		
(iv) Other changes (specify) ▶	(iv)		
o Net increase (decrease) in net assets for the year (add m and n)	o		- 948,071
p Net assets at beginning of year (line 13m, column (a))	p		
q Net assets at end of year (add o and p) (equals line 13m, column (b))	q		- 948,071

15 All plans complete a, b, and c. Plans funded with insurance policies or annuity contracts also complete d and e:

		Yes	No
a During this plan year, was there a termination in the appointment of any person listed in b below?	a		
b If a is "Yes," check the appropriate box(es) and provide the name, position, address, and telephone number of the person(s) whose appointment has been terminated and an explanation for the termination:			
c Have there been any outstanding material disputes or matters of disagreement concerning the above termination? See instructions	c		
d Have any insurance policies or annuities been replaced during this plan year?	d		

Options for b:

(i) ☐ Trustee (ii) ☐ Accountant (iii) ☐ Insurance carrier (iv) ☐ Enrolled actuary

(v) ☐ Administrator (vi) ☐ Investment manager (vii) ☐ Custodian ▶

Explanation for d: If "Yes," explain the reason for the replacement ▶

e At any time during the plan year was the plan funded with:

(i) ☐ Individual policies or annuities, (ii) ☐ Group policies or annuities, or (iii) ☐ Both.

16 Bonding: Yes

a Was the plan insured by a fidelity bond against losses through fraud or dishonesty? . . . . a X
If "Yes," complete b through f; if "No," complete only g.

b Indicate the number of plans covered by this bond ▶ ....

c Enter the maximum amount of loss recoverable ▶ ....

d Enter the name of the surety company ▶ ....

e Does the plan, or a known party-in-interest with respect to the plan, have any control or significant financial interest, direct or indirect, in the surety company or its agents or brokers? . . . . e X

f In the current plan year was any loss to the plan caused by the fraud or dishonesty of any plan official or employee of the plan or of any other person handling funds of the plan? . . . . f X
If "Yes," see specific instructions.

g If the plan is not insured by a fidelity bond, explain why not ▶ ....

17 Information about employees of employer at end of the plan year:

a Does the plan satisfy the percentage tests of Code section 410(b)(1)(A)? If "No," complete only b below and see Specific Instructions . . . . a

b Total number of employees . . . . b

c Number of employees excluded under the plan because of:

(i) Minimum age or years of service . . . . c(i)

(ii) Employees on whose behalf retirement benefits were the subject of collective bargaining . . (ii)

(iii) Nonresident aliens who receive no earned income from United States sources . . . . . . (iii)

(iv) Total excluded (add (i), (ii), and (iii)) . . . . (iv)

d Total number of employees not excluded (subtract c(iv) from b) . . . . d

e Employees ineligible (specify reason) ▶ .... e

f Employees eligible to participate (subtract e from d) . . . . f

g Employees eligible but not participating . . . . g

h Employees participating (subtract g from f) . . . . h

18 Is this plan an adoption of any of the plans below? (If "Yes," check appropriate box and enter IRS serial number): Yes

a ☐ Master/prototype plan, or b ☐ Uniform plan 18

Enter the eight-character IRS letter serial number (see instructions) ▶

19 a Is it intended that this plan qualify under Code section 401(a)? . . . . a

b Have you requested or received a determination letter from the IRS for this plan? . . . . b

c (i) Is this a plan with Employee Stock Ownership Plan features? . . . . c(i)

(ii) If "Yes," were all valuations of employer stock, for the plan year covered by this return/report, made by an independent appraiser? . . . . (ii)

20 a If plan is integrated, check appropriate box:
(i) ☐ Social security (ii) ☐ Railroad retirement (iii) ☐ Other

b Does the employer/sponsor listed in item 1a of this form maintain other qualified pension benefit plans? . . . b
If "Yes," list the number of plans including this plan ▶

21 a If this is a defined benefit plan, is it subject to the minimum funding standards for this plan year? . . . . . a
If "Yes," attach Schedule B (Form 5500).

b If this is a money purchase or target benefit plan, is it subject to the minimum funding standards? (If a waiver was granted, see instructions.) . . . . b

If "Yes," complete (i), (ii), and (iii) below:

(i) Amount of employer contribution required for the plan year under Code section 412 . . . . (i)

(ii) Amount of contribution paid by the employer for the plan year . . . . (ii)
Enter date of last payment by employer . . . ▶ Month ...... Day ...... Year ......

(iii) If (i) is greater than (ii), subtract (ii) from (i) and enter the funding deficiency here; otherwise enter zero. (If you have a funding deficiency, file Form 5330.) . . . . (iii)

22 Answer questions a, b, and c relating to the plan year. If a(i), (ii), (iii), (iv), or (v) is checked "Yes," schedules of these items in the format set forth in the instructions are required to be attached to this form.

		Yes	No
a (i) Did the plan have assets held for investment?	a(i)		X
(ii) Did any nonexempt transaction involving plan assets involve a party known to be a party-in-interest?	(ii)		X
(iii) Were any loans by the plan or fixed income obligations due the plan in default as of the close of the plan year or classified during the year as uncollectable?	(iii)		X
(iv) Were any leases to which the plan was a party in default or classified during the year as uncollectable?	(iv)		X
(v) Were any plan transactions or series of transactions in excess of 3% of the current value of plan assets?	(v)		X
b Is this plan exempt from the requirement that an accountant's opinion must be attached to this form?	b	X	

c If b is "No," attach the accountant's opinion to this form and check the appropriate box. This opinion is:

(i) ☐ Unqualified

(ii) ☐ Qualified/disclaimer per Department of Labor regulations 29 CFR 2520.103-8 and/or 2520.103-12(d)

(iii) ☐ Qualified/disclaimer other

(iv) ☐ Other (explain) ▶

		Yes	No
d If b is "No," do the financial statements or notes to the financial statements attached to this report disclose: *(i)* A loss contingency indicating that assets are impaired or liability incurred; *(ii)* Significant real estate or other transactions in which the plan and (A) the sponsor, (B) plan administrator, (C) the employer(s), or (D) the employee organization(s) are jointly involved; *(iii)* That the plan has participated in any related party transactions; or, *(iv)* Any unusual or infrequent events or transactions occurring subsequent to the plan year-end that might significantly affect the usefulness of the financial statements in assessing the plan's present or future ability to pay benefits?	d		

23 a Is the plan covered under the Pension Benefit Guaranty Corporation termination insurance program? ☐ Yes ☒ No ☐ Not determined

b If a is "Yes," or "Not determined," enter the employer identification number and the plan number used to identify it.

Employer identification number ▶ Plan number ▶

		Yes	No
24 a Is this plan a top-heavy plan within the meaning of Code section 416 for this plan year?	a		X
b If a is "Yes," complete (i), (ii), and (iii) below:			
(i) Has the plan complied with the vesting requirements of Code section 416(b)?	(i)		
(ii) Has the plan complied with the minimum benefit requirements of Code section 416(c)?	(ii)		
(iii) Has the plan complied with the limitation on compensation of Code section 416(d)?	(iii)		
25 Have any individuals performed services as leased employees for any employer covered by this plan or for any other employer who is aggregated with any employer covered by this plan under section 414(b), (c), or (m)? If "Yes," see instructions for completing item 17.	25		X
26 a If the plan distributed any annuity contracts this year, did these contracts contain a requirement that the spouse consent before any distributions under the contract are made in a form other than a qualified joint and survivor annuity?	a		X
b Did the plan make distributions to participants or spouses in a form other than a qualified joint and survivor annuity (a life annuity if a single person) or qualified preretirement survivor annuity (exclude deferred annuity contracts)?	b		X
c Did the plan make distributions or loans to married participants and beneficiaries without the required consent of the participant's spouse?	c		X
d Upon plan amendment or termination, do the accrued benefits of every participant include the subsidized benefits that the participant may become entitled to receive subsequent to the plan amendment or termination?	d		X
27 Were distributions made in accordance with the requirements of Code section 417(e) (see instructions)?	27		X
28 Have any contributions been made or benefits accrued in excess of the Code section 415 limits, as amended by the Tax Reform Act of 1986? N/A	28		X
29 Has the plan made the required distributions in 1987 under Code section 401(a)(9)? N/A	29		X

NATIONAL BUSINESS ASSOCIATION TRUST

\ttachment of Question 12

	(a)	(b)	(c)	(d)	(e)	(f)	(g)
(1)	National Benefit Administrators Inc	61-1009919	None	None	-0-	1,096,026	13
(2)	Doug Walsh	61-0849616	Executive Director	Owner of an employer group	-0-	106,058	25
(3)	Health Care Review Corporation	61-1103352	None	None	-0-	71,476	99
(4)	John Alden Life Insurance	41-0999752	None	None	-0-	23,067	99
(5)	Jack Loewy Marketing	61-1092864	None	None	-0-	12,261	17
(6)	Consolidated Printing	61-0430306	None	None	-0-	58,022	23
(7)	Perrone, Mabry, Phillips	61-1055613	None	None	-0-	10,359	17
(8)	Phillips Advertising	61-1085874	None	None	-0-	2,166	17
(9)	Rice, Seiller, Canter	61-1134462	None	None	-0-	14,223	22
(10)	Porter, Riley, etc.	61-1117724	None	None	-0-	4,114	22
(11)	Agents & Brokers	61-1009919	None	None	-0-	1,423,681	19

OFFICE OF
COMMISSIONER OF INSURANCE

WARREN D. EVANS
COMMISSIONER OF INSURANCE
SAFETY FIRE COMMISSIONER
INDUSTRIAL LOAN COMMISSIONER
COMPTROLLER GENERAL

SEVENTH FLOOR, WEST TOWER
FLOYD BUILDING
2 MARTIN LUTHER KING, JR. DRIVE
ATLANTA, GEORGIA 30334

August 9, 1989

MEMORANDUM

TO: Donald V. Holland
Deputy Insurance Commissioner

THROUGH: Susan D. Hutcheson
Chief Enforcement Officer

FROM: Chuck Huff
Investigator

RE: **National Business Association Trust**

National Business Association Trust appears to have begun solicitation of group medical coverage in Georgia during the later part of 1987. The trust purports to be an ERISA covered plan administered by National Benefit administrators of Louisville, Kentucky. The local marketing and administration is done by Group Concepts Inc. of Albany, Georgia. None of the entities involved has obtained a certificate of authority to transact insurance in Georgia. The administrator is unable to provide any certificate or letter of opinion issued by the U.S. Department of Labor showing they are exempt from state insurance Law.

Erisa Documents:

I requested copies of pertinent documents from the administrator. The request included copies of the trust document, annual reports, summary annual report, CPA and/or actuarial reports, bonds, for fiduciaries and any contracts with agents or administrators.

The trust documents are contained in Exhibit A. The original trust was apparently created as the "Mid-America Soft Drink Bottling Trust in August of 1982. In July of 1987, the trust was restated and the name was changed to the National Business Association Trust. The current Trust Document states that this trust is a Multiple Employer

Welfare Arrangement created consistent with 29USC1003(40)(a).

The plan documents are contained in Exhibit B. The plan documents state on Page 1. that the plan description is prepared and provided to participants in compliance with the "Employee Retirement Income Security Act of 1974" and it contains a statement of ERISA rights on page 12.

The administrator provided copies IRS/DOL Form 5500 for plan years ending July 31, 1986, 1987, an 1988. The first two reports are in the name of the Mid-America Soft Drink Bottling Trust (Exhibit C).

No CPA reports, actuarial reports, or summary annual reports were provided by the administrator. A copy of a bond was provided. The bond does not appear to meet ERISA requirements as it does not cover the proper fiduciaries of the plan (Exhibit D).

Operations:

The Trust is administered by National Benefit Administrators Inc. of Louisville, Kentucky. The trust and the administrator maintain the same address. The administrator subcontracts with Group Concepts Inc. of Albany, Georgia for marketing and claims processing for Georgia participants. All of the funds paid to the trust are maintained in Kentucky and final approval of claim payments is done in Kentucky.

Administration contracts are contained in Exhibit E. Under these contracts National Benefit Administrators retains 20% of the contributions as its administrative fee. Of this 20% 2% is paid to the "Executive Director" and 13% is paid to Group Concepts Inc. Group Concepts in turn pays commission to independent agents for accounts placed with the Trust.

A listing of insureds for the state of Georgia is attached as Exhibit F. The listing reflects that as of May 30, 1989, Group Concepts had 67 Georgia groups and 1 Alabama group placed with the Trust. Various marketing information and the Trust rate manual are contained in Exhibit G. It is clear that this program is marketed to Employers of in almost any industry.

Financial Status:

The three years of financial information, for the period July 1985 through July 1988, is on the IRS/DOL form 5500's. The information on these forms shows during the period 87/88 plan year the trust increased in size at a staggering pace, from 2426 participants to 16,623 participants. Over the three year period these reports also reflect a deterioration in the financial status of the trust. Assets were reported as $449,254 in July of 86, $160,694 in July of 87 and -$787,377 in July of 1988. From July of 87 to July of 88, expense exceeded income by $948,071. It is clear that the trust is operating on a cash flow basis only and has no surpluses or reserves.

As the financial information on the latest form 5500 is 1 year old, I requested more current information. The only additional information provided is a loss ratio run which reflects a 78% paid loss ratio (See Exhibit H). Using this information and certain estimates it appears the financial position of the trust through May of 1989 would be approximately as follows:

	- Collections	$29,693,611
	- Paid Claims	$23,266,497
(Est)	- Expense	$ 5,939,000
(Est)	- Life & Reins Cost	$ 2,791,000
(Est)	- IBNR	$ 4,750,000
SUBTOTAL		-$ 7,053,114
+ Est Reins Recovery		+$ 1,400,000
		-$ 5,653,114

By letter dated July 28, 1989, I have requested confirmation of these estimates or actual accounting information; however, I feel it is unlikely I will receive a response.

Given all the information available, it appears very clear that this is purely a cash flow operation and should contributions slow significantly or be stopped, there will be a serious problem with unpaid claims.

Attorney of Record:

I have received correspondence from Scott T. Wendelsdorf of the firm Ogden Sturgell and Welch of Louisville, Kentucky. The attorney's letter states that he is attempting to obtain a determination from the U.S. Department of Labor as to the ERISA status of the Trust and from the verbiage of the letter I presume we will receive no further information from the administrator. (see Exhibit I correspondence file).

Conclusions:

It appears National Business Administrators/Group Concepts Inc. and National Business Association Trust are in violation of code § 33-3-2 as they are transacting the business of insurance without obtaining a certificate of authority.

It appears that Group Concepts Inc. and/or any subagent is in violation of code § 33-23-20 and 33-5-1 as they are placing business with an unauthorized insurer.

Given the apparent financial condition of the trust it appears it should be considered impaired and deemed to be insolvent in accordance with code § 33-37-2.

CH

/blw

APPENDIX 3

INCOME SECURITY REPORT

Crying Wolf?

Labor Department inspector general Raymond Maria says the nation's pension plans are ripe for looting, but his superiors see no cause for alarm and have shackled his authority.

BY KIRK VICTOR

Raymond Maria seems to be right out of central casting: a tough former FBI special agent whose role is to wage war for the government against would-be plunderers of the nation's trillion-dollar-plus pension system. Maria, the Labor Department's acting inspector general (IG), relishes that assignment and draws freely on lessons learned during his 15 years at the FBI, where he concentrated on investigating organized crime and labor racketeering. He often says that the best way to deter crooks is to hit them with criminal charges—not the administrative or civil remedies that the Labor Department uses, he says, all too frequently.

Former FBI special agent Maria
Auditing has become "a perfunctory exercise."

Richard A. Bloom

Maria's hard-nosed approach has gained attention: On his office wall, he is pictured with Sen. Sam Nunn, D-Ga., chairman of the Governmental Affairs Permanent Subcommittee on Investigations, with the inscription: "To Ray, a great friend and real fighter in the battle against corruption."

But Maria now has a different battle on his hands. He has run into a swarm of critics who say private pension assets are in no apparent danger and certainly don't face a threat of anywhere near the magnitude that Maria suggests. And Maria is also up against the Justice Department, which he says is undercutting his authority, and the upper echelons of the Labor Department.

The uproar began in June, when J. Brian Hyland, who recently retired as Labor's IG after undergoing surgery, sent his semiannual report to Capitol Hill. That report, which Maria helped write, included sweeping charges that the safeguards designed to protect nearly $1.7 trillion in private pension plans have been "dissipated" through a combination of "permissive regulations and lax enforcement" of the 1974 Employee Retirement Income Security Act (ERISA). In a conclusion that provoked anger within the pension and accounting industries and prompted congressional hearings, the report warned that "unless steps are taken now, today's [savings and loan] bailout may become tomorrow's ERISA nightmare."

The reference to the S&L crisis has become a lightning rod to critics who say that the IG's office can't back up such an inflammatory charge.

Former Rep. John N. Erlenborn, R-Ill., who helped write the 1974 pension law and is on the Labor Department's ERISA advisory council, dismissed the reference as "pure hogwash" and "an attention-grabber." Though he acknowledged that enforcement of ERISA "certainly could be improved," Erlenborn, a partner in the Washington office of the Chicago law firm of Seyfarth, Shaw, Fairweather & Geraldson, said that the pension system is "not facing any kind of debacle like the S&L crisis."

"There's nothing more inappropriate than comparing the pension system as it exists today to the S&L crisis," said Dallas L. Salisbury, president of the Employee Benefit Research Institute (EBRI), a nonprofit Washington group that conducts research for corporations. "It's just gross irresponsibility and sensationalism," he said, and the question is, "What is the motivation? Why would one compare this to the S&L situation?"

Salisbury said that because of the lack of evidence in the IG report, heads should roll. "A comparison to the S&L crisis based on what was in the printed document [was so irresponsible] that I would happily say that the individuals putting that forth shouldn't be public servants," he said. "If you're going to scare the retirees of the nation by implying that their [pension] system is about to collapse, then to me that's something one should be pretty damned careful about doing. And they should make damned well and certain that with numbers and with situations, they can categorically show that the problem is that big. And if he can do that and if it is really that way and he can show it, then more power to him."

Georgetown University law professor Roy A. Shotland said that the IG was "throwing a bomb" to get attention. "The really big money [in pensions] is by and large in places where someone is watching: actuaries, lawyers or major unions," said Shotland, a specialist in pension law. "Most players of [such] size go by the rules. . . . Criminal [violations] are on the fringe."

Such criticisms don't deter Maria, who stands by the report and is still speaking out against what he calls the substandard performance of independent accountants and his department in identifying and punishing ERISA violations. Maria, who served as deputy IG from 1984 until stepping into the acting IG post in October, said the report correctly warns that the country's pension plans are "highly vulnerable to fraud and abuse."

The department's difficulties are compounded by woefully inadequate resources, according to Maria. To enforce ERISA, which was enacted to protect workers' pension and welfare benefits, the department has about 300 auditors and investigators who are responsible for overseeing more than 870,000 pension plans. Because of the disparity between the number of regulators and the number of plans, the department each year reviews fewer than 1 per cent of ERISA-covered plans.

Maria said that he is particularly concerned that a new, wilier class of crooks, realizing that pension plans aren't well monitored, will be enticed to make off with their assets. Sophisticated business crimes, from elaborate insider trading schemes to the plundering of savings and loans, have become commonplace, he says, and he sees no reason for pension plans to be immune from such predations.

"There is compelling evidence that those with a criminal inclination have recognized vulnerabilities caused by the imbalance in this asset-rich area," Maria said in an interview. "There is a new generation of racketeers that has evolved from the ethnic stereotype," he said. "Racketeers disguised as attorneys, bankers, accountants, beneficiary plan administrators, portfolio managers, doctors and dentists. . . . Everyone wants to think that it's just Teamsters and labor [unions] who pillage their members' benefit plans. That clearly is not the case."

Even as the controversy continues, Maria seems unfazed by his office's critics. "I am not railing as part of a rhetorical exercise," he said. "I'm very serious about this. These are issues of fundamental importance. . . . I like to think that the office of inspector general can be responsive to those situations that cry out for investigation and redress without regard for political consequences."

But despite Maria's contention that the 1978 Inspector General Act gives his office broad authority to aggressively pursue criminal cases, the Justice Department recently determined that the IG can investigate only cases involving federal funds or federal employees. That decision, which the Labor Department supports, has resulted in the suspension of about 1,200 criminal investigations by Maria's office and has upset other IGs throughout the executive branch. *(See box, p. 2632.)*

ASSESSING RISKS

Labor Department officials are cognizant of the fallout that occurred when warnings from the Housing and Urban Development Department (HUD) IG were ignored by that department but were later proven accurate by revelations of massive fraud. Thus, Labor officials have been quick to respond to the charges in the IG's report.

Deputy Labor secretary Roderick A. DeArment, in an interview, said the report's charges are "not supported by empirical evidence" and could "unnecessarily cause people to be alarmed." Echoing that view, Alan D. Lebowitz, deputy assistant secretary for program operations in the department's Pension and Welfare Benefits Administration, said, "The empirical evidence doesn't show systematic fraud, and the regulatory environment has, if anything, gotten tougher over the past six-eight years."

In a September letter to Rep. Tom Lantos, D-Calif., chairman of the Government Operations Subcommittee on Employment and Housing, DeArment wrote: "Neither the inspector general's reports nor the Department of Labor's enforcement experience demonstrates that the nation's private pension system is unsound. In fact, it has never been healthier."

On the other hand, DeArment also pointed out steps that the department is taking to enhance enforcement of ERISA, including the establishment of a computerized data base to review annual reports, the issuance of regulations that would provide new civil penalties for inadequate reports and a system of referring accountants who perform substandard work to professional organizations for disciplinary action.

DeArment, in the interview, said that he agreed with Maria that "if all you have is civil enforcement, then people will be emboldened to steal from plans," but he added that "most violations that we are talking about do not involve stealing. . . . I have a more difficult time relating to very abstract technical violations [that are] not appropriate for criminal [sanctions]." And he said he disagreed with warnings that the pension system faces a grave threat or that "the whole system is on the verge of collapse."

Maria is quick to acknowledge that the department's new leadership, Secretary Elizabeth H. Dole and DeArment, "appears to be sensitive to our concerns and observations and is committed to a review of the entire [criminal] enforcement question."

But, Maria said: "The department sees itself as a social-service-oriented [agency], and it doesn't see vigorous criminal en-

John Eisele

Pension expert Dallas L. Salisbury
"Why compare this to the S&L situation?"

Fencing In the IGs

What started as a jurisdictional dispute between the Labor Department's inspector general (IG) and its solicitor has become an all-out turf battle pitting virtually all 24 IGs in the executive branch against the Justice Department. At issue is how far an IG's authority extends in conducting investigations, particularly criminal probes.

The issue arose when then-Labor solicitor George R. Salem in September 1988 asked Justice's Office of Legal Counsel whether the IG was authorized to pursue investigations into alleged violations by private individuals of statutes administered by the Labor Department. Justice's opinion said that the IG's focus should be on eliminating waste and fraud among the department's employees and operations. The IG is limited to overseeing investigations, not conducting them, the opinion said. Moreover, it said, investigations should be confined to recipients of federal funds and to department personnel and should not be aimed at private individuals.

That decision, issued last March, has sent shock waves through IG offices and on Capitol Hill. The Senate Governmental Affairs Committee held a hearing in early October on the opinion's ramifications, and chairman John Glenn, D-Ohio, said in an interview that Justice's limited view of the IG's authority was "ridiculous." Glenn did not rule out amending the 1978 Inspector General Act to spell out the IG's authority, but he said he hoped that discussions involving Justice, State Department IG Sherman M. Funk and others would produce a workable compromise.

Labor's acting IG, Raymond Maria, has dropped about 1,200 pending criminal investigations as a result of the opinion. If his office can't conduct criminal fraud investigations involving pension plans, "the public will be ill-served and the American working force will be the losers," Maria told the hearing. "If [the IG] does not conduct these investigations, they will, in almost all instances, disappear."

Other IGs have been similarly blunt. "Toe dancing on who can do what is making us very uneasy because we have programs rife with fraud," Interior Department IG James R. Richards fumed. "You don't define investigative jurisdiction by who you investigate but by what constitutes the crime. We're in a real quandary."

But some in the private sector agree with Justice that to avoid conflicts of interest, the IG's jurisdiction should be limited. "I think it's stupid, plain outright stupid, for the IGs to insist on line investigative functions," Washington attorney Michael S. Gordon, a specialist in pension law, said. The IG should investigate cases of fraud, corruption and waste, he said, "not how well pension plans are being run or how employers are dealing with safety regulations. That's what we hire other people for." Gordon wondered how, for example, Labor's IG could oversee misconduct if he had to evaluate his own office: "How can the IG [investigate] the IG?"

forcement as consistent with its social service goals. When you rely on fines and administrative actions, you foster a climate in which crimes are worth committing. The benefits are so high and the risk and cost of being caught are so low that the question is, 'Can I afford the fine?' "

Maria's long-standing concern about problems in ERISA oversight was reinforced by a study the IG's office conducted from July 1986-July 1987. That study focused on 168 pension plans that contained $6.7 billion in trust for 500,000 participants. The IG's office of labor racketeering as well as the Pension and Welfare Benefit Administration already had identified about $18.7 million in misused assets in those plans, but the IG wanted to determine how thorough the independent accountants had been in disclosing such deficiencies in their audits. (ERISA requires annual independent audits of plans covering 100 or more participants.)

Despite the fact that the 168 plans contained statutory violations of ERISA, according to the IG study, the independent auditors failed to find or disclose 17 cases of criminal violations involving misuses of funds ranging from $7,000-$5 million. The auditors also failed to identify or disclose $16.4 million in ERISA violations of the $18.7 million that the IG had identified.

The IG found that more than 50 per cent of the independent audits lacked one or more disclosures required under ERISA or under the auditor's own reporting standards and that the reports weren't received by Labor until 22-26 months after the audited years. The study, issued in December 1987, concluded that the "risk for misuse" of pension assets was "greater than Congress had envisioned" because "sufficient enforcement and reporting safeguards are not in place to deter or expose fund misuses."

Criticisms of the "skewed" sample used in the IG's 1987 study prompted another IG review of a "statistically valid sample" of 279 benefit plan audits. The results of that review are expected to be issued shortly, but department sources suggest that its conclusions will not differ markedly from the 1987 study.

"The audit of benefit plans in all too many cases has become a perfunctory exercise," Maria said. "[Independent accountants] see their client as [the plan] administrator and trustees. We see their client as the participants, and the Secretary of Labor as the guardian of the participants."

SUGGESTING FIXES

Maria's recommendations for statutory changes—as well as his emphasis on deficiencies in ERISA supervision, coupled with the conclusions from the IG's 1987 study and the warnings in the IG's June report—continue to rile many who work in the pension field as well as some Labor officials who were stung by the report's criticism of the department's "ineffective", oversight.

At an August hearing by Lantos's subcommittee, Maria said that throughout ERISA's history, deficiencies in enforcement have been "extensively chronicled" by the General Accounting Office, internal department reviews and congressional committees.

Indeed, a 1986 report by the Senate Governmental Affairs Subcommittee on Oversight of Government Management concluded that despite the millions of people dependent upon ERISA-covered pensions, the department's implementation of the law was characterized by "grossly inadequate resources, long-standing deficiencies, frequently changing and inconsistent leadership and shifting enforcement strategies."

Maria recommended in his testimony that Congress amend ERISA to expand the role of the outside accountant in the enforcement process rather than simply adding more personnel to the federal payroll at a time of budgetary constraints. He would require independent public accountants to search for prohibited transactions and to report their findings directly to the Labor Department as well as to pension plan administrators and trustees.

But Andrew J. Capelli, chairman of the employee benefit plans committee of the American Institute of Certified Public Accountants, made clear in an interview that accountants "are not government employees."

In testimony before the Lantos subcommittee, Capelli said that the IG's 1987 study was "based on a nonrepresentative and limited review." He acknowledged that some audits were of poor quality and said that the institute has set up a committee to work with Labor on problem areas. Capelli testified that if Congress decides to expand the role of the independent auditor in reviewing ERISA plans, that would entail "significant costs," but he said the institute would work with the department to establish appropriate procedures.

Howard C. Weizmann, executive director of the Washington-based Association of Private Pension and Welfare Plans, whose members administer employee benefit plans, said that he was concerned about talk of criminal sanctions in the single-employer pension area, where fraud is "very nominal." Weizmann asked, "Does one, in order to catch a few potential bad actors, put a straitjacket" on the entire system?

EBRI's Salisbury said that the defined-pension benefit system, in which an employer promises a worker a fixed benefit each year of the employee's life after retirement, is "better funded than at any time in history, [and] investment diversification is greater than it has ever been."

Salisbury said that the "vast majority" of pension funds is handled by professional investment managers who are regulated in whichever way their industry is regulated: insurance companies by insurance commissioners, banks by bank regulators, mutual funds by the Securities and Exchange Commission.

"You've got steps of regulation, but if you read the IG's report, you're left with the impression that pension plan people are managing all of this money themselves and are making daily decisions on whether to buy this or sell that—that it is somehow one big pool of money in a way that it is not," Salisbury said.

Oversight by other government agencies is not good enough for Maria. He said that for investments in regulated entities such as banks, "the assumption is that someone else is auditing it," but "at best, there is sporadic review by other regulatory agencies, . . . and not with adherence to requirements laid down by ERISA." Maria has called for the elimination of so-called limited scope reviews, now allowed under ERISA, in which pension assets held in trust in a government-regulated industry such as a bank or insurance company may be omitted from an audit.

WHO'S RIGHT?

The flap over ERISA may leave pension-plan participants in a quandary over what to believe. On the one hand, there is the IG, whose job is, as Maria put it, to be a "professional skeptic" and whose assignment is to root out waste, fraud and abuse. On the other hand, there are Labor Department officials and representatives of the pension community who sharply disagree with the IG and who see no imminent disaster for ERISA.

Michael S. Gordon, a Washington lawyer and longtime specialist in the employee benefit area, said: "There is no overwhelming or even clear-cut evidence that we're on the brink of a crisis. Nevertheless, you'd have to be living on another planet not to recognize that we've gone through—and are still going through—a period of tremendous fraud and corruption in virtually every industry and occupation in the country, from defense to athletics and generic drugs to HUD to the savings and loan industry. You name it: Just about everywhere you look are scandals of epic proportions.

"I think folks who dismiss [the IG's report] generally tend to represent [the pension] industry in one form or another," Gordon continued. "So, it's a natural reaction, a natural tendency for them to say: 'We're from Missouri—show us. Show us the proof; don't make a lot of speeches.' "

Potential problems in ERISA exist, Gordon said, because some of the fraud and corruption uncovered in the securities industry is "closely connected in one form or another to pension plans." Some of those in the securities industry accused of insider trading, according to Gordon, "also were responsible for assisting in the financing of takeovers or financing against takeovers [by using] pension funds. . . . To say that none of that resulted in any potential for tremendous fraud taking place in the private pension plan area I think would be unwise."

Gordon noted that the IG and his staff "are people who have to be regarded as folks who rely a great deal on their experience and instincts in the area of fraud and corruption. When [they] tell you that they are worried that something very serious may be going on, you have to pay attention. . . . Just because they haven't put it together and tied it up with a ribbon for us [doesn't mean] that we can dismiss it out of hand."

Maria and the IGs throughout government have received a strong vote of confidence from some leaders on Capitol Hill. Lantos said that Maria "is a watchdog who perceives his function as it should be; a junkyard dog who blows the whistle early on. . . . My view as chairman of the oversight subcommittee is to treasure an IG who alerts me before we lose $150 billion. Both the inspector general [Hyland] and the deputy inspector general [Maria] deserve tremendous praise—I'd give both of them awards."

Despite the praise, however, Lantos hedged his bets about whether a legislative fix to ERISA is needed, saying he wanted to hear from academic experts and from Secretary Dole first.

Maria said that he is more convinced than ever that "we have responsibly accomplished one thing: We've alerted Congress and the public to vulnerabilities that we believe should be explored. . . . The easiest thing for the IG to do is to investigate after the fact and give a litany of disasters and a body count."

In the meantime, Maria's status is uncertain: He is one of many candidates under consideration by the Bush Administration for the IG post. But he continues to sound off.

"None of [the IG's critics], I venture to say, has ever talked to a victim participant," Maria said. "I and my colleagues do every day. These self-ordained outside experts are people entitled to their opinion, but they are not informed about the world of enforcement and about fraud. I daresay some of these people couldn't find 'fraud' in the dictionary." □

John Eade

Attorney Michael S. Gordon
There are scandals everywhere.

PART I

Los Angeles Times

SUNDAY, OCTOBER 29, 1989

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Pension Plans Looted as Safeguards Weaken

■ Fraud: Despite warnings, about $4 billion in retirement income may have been taken by racketeers.

By DOUGLAS FRANTZ
and ROBERT L. JACKSON
TIMES STAFF WRITERS

CHICAGO—When his wife fell gravely ill, George Hohol wanted to quit his job as a welder so he could get his pension money to pay her soaring medical bills. But she begged him to keep working so they would have health insurance.

Hohol stayed on the job, but his health insurance was canceled a few months later without warning because his employer had stopped paying the premium. Then the paychecks started to bounce, and finally the company closed in late 1986.

The worst was yet to come. When Hohol tried to get the $29,000 accumulated in his pension plan over 22 years, he got excuses and delays instead. Ultimately he learned the money was gone, lost in an elaborate fraud scheme by the owner and a lawyer for the small company, DuPage Boiler Works, in the Chicago suburb of Naperville.

FIRST OF TWO PARTS

Hohol, a proud man who came to the United States from Poland after spending World War II in German labor camps, was $52,000 in debt and had been on unemployment for the first time in his life when his wife died in 1987.

"My wife cried and cried because she hadn't let me quit before and get my money," Hohol said. "Her heart was broken, and I'm sure she died faster."

Hohol and his wife were victims of what a federal official describes as "a new generation of racketeers"—businessmen and lawyers who exploit weak government regulation to misuse and steal the retirement income of workers across the country.

The U.S. Labor Department, according to its acting inspector general, has proved powerless to deter abuse or to bring the wrongdoers to justice. The inspector general estimates that $4 billion in pension funds are being misused, but in reality, no one knows how deep the problem is.

"The nation's pension and welfare plans are vulnerable to fraud [illegible] because of a flawed enforcement strategy adopted by the Labor Department that relies too much on civil remedies and not enough on criminal prosecution," said Raymond Maria, the acting

Please see PENSION, A32

PENSIONS: CAN FRAUD BE STOPPED?

PENSION: Weak U.S. Regulation Exposes Funds to Fra

Continued from A1

inspector general.

Most pension plans, the experts say, are run honestly. Most workers will find their money waiting for them when they retire. And many pension plans—but by no means all—are federally insured in case the money runs out.

Most abuse is found among relatively small employers—the same ones that are least likely to be covered by federal insurance.

The wrongdoers include small business owners who can't resist dipping into pension funds, such as a California construction company where $227,000 in pension funds was used to run the business.

And they include those who appear intent on looting the funds from the start, such as a New Mexico potash mine owner accused of siphoning off $9 million in worker retirement funds to pay personal debts and finance a lavish life style.

The enormous size of today's pension funds makes them attractive targets for the undeserved and the unscrupulous.

Assets in private pension funds tripled in the last 10 years to $1.7 trillion—about $7,000 for every man, woman and child in the country. More than 76 million workers and retirees are covered by a pension plan.

But internal government audits, interviews and court records raise questions about whether the federal government's ability to keep this vast pool of money safe for workers has kept pace with the mushrooming growth.

Consider this statistic: The U.S. Labor Department agency responsible for monitoring the nation's 870,000 pension plans has only 260 auditors and investigators assigned to the task.

They review fewer than 1% of the plans each year. The least attention goes to the most vulnerable plans, the small ones that are not supervised by the outside auditors and layers of lawyers hired by large corporations.

Congress and the Labor Department inspector general's office, the internal watchdog that is supposed to make sure the department is doing its job, have issued repeated warnings about the inadequate resources. In 1986, a Senate committee concluded that inadequate staffing has dangerously compromised the department's ability to protect worker pensions.

And earlier this year, a study of 165 plans by the inspector general's office uncovered $12.7 million in misused funds. At that rate, the office said, there would be $4-billion worth of fraud and abuse systemwide.

Not long ago, the problem was far worse. Before Congress enacted the Employee Retirement Income Security Act (ERISA) in 1974, only a minuscule 3% of workers received the full benefits to which they were entitled.

The 1974 law put the Labor Department's Pension and Welfare Benefits Administration in charge of monitoring pension plans. In 1978, when Jimmy Carter was President, the office conducted 3,000 reviews and investigations. By 1988, the figure had plummeted to 1,852 despite the threefold increase in pension-fund assets.

A PWBA spokeswoman explained that the agency has undertaken larger, more sophisticated cases in recent years. "Our enforcement strategy is that quality is more important than quantity," she said.

The agency concentrates on the largest 5% of the plans, which hold roughly 90% of pension assets. The 95% of the plans with fewer than 100 participants are least likely to be reviewed, and they are not required to hire outside auditors to ensure that the money is being handled legally.

"Making sure $1.7 trillion is invested wisely for the workers and retirees is an impossible task," said Karen W. Ferguson, director of the Pension Rights Center, an advocacy group for workers based in Washington. "It is not the fact that the Labor Department is not doing its job, but the fact that it is an impossible job to do given their limited resources."

Government regulators such as the Internal Revenue Service and the Securities and Exchange Commission try to maximize limited resources through criminal prosecutions that send a strong message of deterrence.

But the Pension and Welfare Benefits Administration relies almost entirely on civil and administrative sanctions. Of the PWBA's 6,000 investigations in the last three years, only 95 were classified as criminal and only 26 convictions resulted.

Maris, the acting inspector general, contends this strategy reassures would-be pension pillagers. The worst that will happen, in the unlikely event they are caught, is likely to be a civil fine.

Pension-fund regulation today, the inspector general's office and others argue, is comparable to the woeful monitoring that contributed to the collapse of the savings and loan industry, a debacle expected to cost taxpayers at least $150 billion.

The Pension Benefit Guaranty Corp., which was set up by the 1974 ERISA law to insure workers' pensions, has a deficit of $4 billion—the difference between what they owe pensioners and what they can expect to receive in the form of employer premiums.

A big chunk of the $4 billion is a disputed $2.3 billion in pension obligations left by the 1986 bankruptcy of LTV Corp. Although the PBGC has gone to court against LTV in a fight over responsibility for making the pension payments, it has also been making the payments for the last three years.

In 1987, for the first time, the PBGC paid out more money to cover pension obligations than it collected in employer premiums. The General Accounting Office, an investigative arm of Congress, warned that the fund would be broke—unable to meet its current obligations—by 2001.

Congress reacted by increasing the insurance premium paid by employers, now the sole source of revenue for the PBGC. But PBGC officials are still concerned about potential problems with underfunded pension plans in big industries, such as the airlines.

The Labor Department's inspector general's office says a major shortfall could ultimately land in the taxpayers' laps, just as Congress turned to the taxpayers after another government insurance agency fell short of the funds it needed to pay insured depositors at failed S&Ls.

Pension fund system representatives and some Labor Department officials say such concerns are exaggerated.

'My wife cried and cried because she hadn't let me quit before and get my money. Her heart was broken, and I'm sure she died faster.'

—George Hohol

"Generally, the private pension system is probably stronger than it has ever been," said Alan D. Lebowitz, deputy assistant secretary for operations at the PWBA. "People should not be overly concerned about the stability of the system or the integrity of the system."

Nonetheless, the Labor Department recently informed Congress that it was considering tighter regulations on audits by outside accountants, one of the recommendations from the inspector general.

Although he maintained that corruption has been restricted to a small number of pension plans, Lebowitz acknowledged: "I think they are highly vulnerable to abuse. Pension funds are pots of money sitting there to pay future benefits."

□

Jeanette Kurns grew concerned in early 1986. Paychecks from DuPage Boiler Works, the company where her husband—like George Hohol—had worked for 22 years, were getting tough to cash. The local bank refused to honor them, and she had to be on the doorstep of the bank that issued the checks early in the morning to get them cashed before funds in the account ran out.

For a half century, DuPage Boiler Works had run smoothly, if somewhat modestly. The work was steady, the overtime occasional. And if the hourly pay was less than other places, the workers were reminded every year that the company was setting money aside for them in a pension fund.

But in October, 1984, the company had been sold to a man who identified himself as Robert Caldwell. He had big plans and built a fancy new office to go with them. He was driven to work in a limousine and gave the workers free turkeys the first Thanksgiving and again that Christmas.

Only later would they discover that their pensions had probably financed that generosity.

Within two weeks of taking over, Caldwell had begun raiding the profit-sharing account, according to court records. He had $350,000 transferred to another account and used some of the money to pay debts of another company he owned. Some of it went to such expenditures as a fur coat for himself and $45,000 worth

Jonathan Kirn

James and Jeanette Kurns, left, show scrapbook from their effort to stop fraud at DuPage Boiler Works in Naperville, Ill. George Hohol, above, stands on vacant lot that used to be DuPage.

of clothes for his wife, according to Joan B. Safford, a federal prosecutor in Chicago.

Caldwell was actually Morton Scherl, a white-collar criminal with an arrest record dating to the mid-1960s in Los Angeles. When he bought DuPage Boiler, using the company's own money for the purchase, he was a fugitive wanted in New York, Massachusetts and Florida.

By May, 1986, Scherl and William B. Goodstein, a Chicago lawyer, had wiped out DuPage Boiler's $741,000 profit-sharing account. About $36,000 had gone in small amounts to retiring workers to silence their complaints about not getting their pensions. The rest, court records show, went to Scherl and Goodstein and a variety of their businesses.

In sucking the cash out of DuPage, Scherl had also stopped paying the utility bills or paying for raw material. And even though money was still being deducted from paychecks, he stopped paying withheld taxes to the IRS and canceled the health insurance policy.

For seven months in 1986, Jeanette Kurns tried to get someone to take a look at what was going on at DuPage. She wrote to President Ronald Reagan, the Labor Department, the IRS and various state agencies. She has a large blue binder filled with her futile correspondence and notes of her telephone conversations.

"It was like a brick wall everywhere I turned, especially at the Labor Department in Washington," Kurns said. "The Department of Labor told me this was going on in such wide numbers that they didn't have enough investigators to go out and check."

Charles Lerner, the PWBA enforcement director, refused to comment directly on the DuPage Boiler case. But he said citizen complaints are one source for the agency's investigations of pension-fund problems.

"We get thousands and thousands of phone calls," he explained. "The numbers are so huge."

Eventually state authorities and the U.S. attorney's office began to investigate DuPage Boiler Works in the fall of 1986.

That October, an IRS agent approached Scherl in the coffee shop of a Sheraton Hotel outside Chicago and told him he was under arrest. Scherl dashed through the hotel kitchen into the parking lot and fled. It was a year and a half before he was captured in Baltimore, where he was in the midst of another scheme.

Scherl recently pleaded guilty in federal court in Chicago to misusing DuPage Boiler's pension funds and other charges and is awaiting sentencing. Goodstein, the lawyer, was convicted and sentenced to three years in prison.

At Goodstein's trial, George Hohol and Jeanette Kurns were among several witnesses who testified about the financial hardship resulting from the pension fraud. Safford, a veteran prosecutor with a reputation for toughness, was so upset by Hohol's story that she left the courtroom to avoid crying in front of the jury.

Witnesses also described their frustrations with the Labor Department, prompting the presiding judge, Charles P. Kocoras, to offer lawyers in the case his view on the department's response.

"One of the witnesses said she called Washington and they told her not to worry about it," Kocoras said from the bench. "Here they are getting fleeced out of all of this money, and Washington is advising these people not to worry."

□

The Pension Benefit Guaranty Corp. was established by the ERISA law to insure the pensions of workers and retirees. If employers do not provide enough money to cover promised benefits when a plan is ended, the agency will pay them up to a ceiling that is now set at $2,028 a month.

However, the PBGC insures only what are called defined-benefit plans, which promise a specific monthly benefit at retirement. As a result, only 107,500 of the 870,000 pension plans are insured, although the covered plans represent 40 million workers and retirees out of the 76 million enrolled in pension plans.

Defined-contribution plans, whose ultimate pension benefit is not predetermined, are not insured by the PBGC. Most common among these are profit-sharing plans, employee stock ownership plans and 401(k) savings plans.

James B. Lockhart, executive director of the PBGC, said the percentage of workers covered by defined-benefit plans has declined steadily in the 1980s. More worrisome to Lockhart is the fact that most new pension plans are defined-contribution plans, which

Please see PENSION, A13

LOS ANGELES TIMES

PENSION: Funds Ripe for Fraud

Continued from A22

are not insured by the government.

The DuPage Boiler Works' profit-sharing plan was not insured. After the company closed its doors, a court-appointed trustee for the pension plan recovered enough during bankruptcy proceedings to pay workers about 80% of their pensions. But the faith of people like Jeanette Kurns was shaken badly.

"You think that money is as safe as the money in your bank account," she said.

□

Lerner, the PWBA enforcement director, said the agency has tried to cover more plans by focusing its enforcement on financial consultants who advise multiple plans and on financial institutions that hold the assets of many plans.

But an examination of cases against consultants and financial businesses in recent years raises doubts about the agency's effectiveness in this arena.

Last May, the department filed a civil lawsuit against the New York brokerage house Shearson Lehman Hutton, two smaller investment firms, three former brokers and several fund trustees. The defendants played a role in managing $560 million belonging to several Teamsters Union pension and welfare plans in Utica, N.Y.

The suit, which is pending, charged that the plans lost money in a scheme in which the brokers bought stocks and placed them in a holding account for several days. Losing trades were assigned to pension-fund accounts and profitable trades went into the accounts of friends, relatives and other customers, including some plan trustees, the suit contends.

But this was not a case of the Labor Department's ferreting out alleged wrongdoing. The lawsuit followed a 6-year-old criminal investigation by federal prosecutors and the Securities and Exchange Commission, which had already led to guilty pleas by three brokers.

The department was equally late in the case of Glen E. Dawson of Annapolis, Md., a former IRS auditor who invested funds for about 200 small pension funds and drove a Mercedes-Benz sports car bearing a license plate reading "ERISA."

Dawson, who handled pension investments for doctors and accountants, promised high returns for the pension funds of the professionals and their employees.

ERISA prohibits those responsible for pension money from accepting fees for investing the funds in a particular institution. But for several years, according to a lawsuit filed in Baltimore, Dawson invested pension-fund assets with companies that paid him substantial commissions and fees in return.

One client, a Midwestern accountant, said he was questioned by a Labor Department investigator in 1983 about Dawson's operation. The accountant said he provided a sworn statement to a department lawyer that year but never heard anything further and kept using Dawson.

Dawson stayed in business until outside events intervened. He was also chairman of a Baltimore savings and loan association, and the state seized the S&L in December, 1985, because it was insolvent.

Court records show that the S&L had lent Dawson $105,000 and that he had invested pension-fund money in the thrift when it was struggling to survive what Maryland regulators charged was "gross mismanagement and plundering" by its officers, including Dawson.

In August, 1986, the Labor Department filed a civil lawsuit accusing Dawson of violating ERISA. Court files indicate the pension plans operated by Dawson, which were uninsured, had lost up to $1 million in what the lawsuit called a pattern of unlawful transactions covering seven years and 130 plans.

Last year, a federal judge banned Dawson from the pension business and ordered him to repay the plans a total of $70,000 in restitution. Dawson had filed for bankruptcy earlier, and a lawyer in the case said $70,000 was about all he had left by the time the Labor Department got to him.

Part II

Los Angeles Times

MONDAY, OCTOBER 30, 1989

Flawed Pension Safeguard Costs Miners Millions

By DOUGLAS FRANTZ
TIMES STAFF WRITER

ALBUQUERQUE—Like many Texas businessmen in 1985, Tom Lundberg was being squeezed by collapsing real estate prices. But he hit upon a novel solution: buying a New Mexico potash mine at a time when the potash industry was as bad off as Texas real estate.

Peculiar as Lundberg's plan might have seemed, a clue to his intentions may have emerged at the closing of the potash mine sale on Dec. 31, 1985. He and his lawyer, John N. Sanders, delayed the final signing for two hours while they waited for a letter listing the exact assets in the mine workers' pension plans.

Lundberg signed when he got the answer. And within 15 days, according to court records, he had already moved $2 million out of one pension fund. A million dollars of it went to Sanders as legal fees, and $443,000 to Lundberg to pay some of his real estate debts, according to the records.

SECOND OF TWO PARTS.

That was just the beginning.

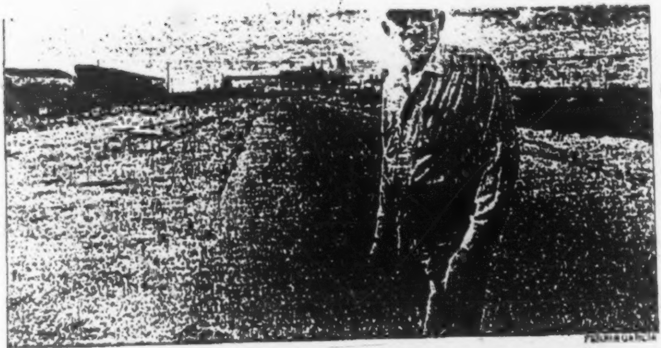
Over 18 months, a total of about $9 million was withdrawn from the retirement accounts of 900 mine workers and retirees in what a federal grand jury in Albuquerque charged last March was a series of elaborate sham transactions that amounted to embezzlement.

Before authorities or the workers realized what had happened, Lundberg Industries was in bankruptcy and, court documents show, the once-robust pension plans were within weeks of running out of money.

"The scary part about pension fraud is that we don't even know about it until somebody goes into bankruptcy," said Michael F. Treworgy, the regional inspector general for the U.S. Department of Labor. "How many others do we not know about?"

It was not the Labor Department that discovered the problems in the pension plans at Lundberg Industries, although monitoring them is

Please see PENSIONS, A12



Leo T. Evans stands near the potash mine he worked for 25 years and depends on for pension money.

PENSIONS: Mine Owner Indicted

Continued from A1

the agency's responsibility. Mine workers who asked the Labor Department's pension division for help ran into a stone wall.

"The employees were aware of some of their rights as far as the pensions went, but they couldn't get any answers," said W.T. Martin, the local attorney representing the workers. "They got the runaround."

So the workers and retirees, resorting to an unusual New Mexico law, collected 600 signatures on a petition requiring the local district attorney to open a grand jury investigation. Meanwhile, the bankruptcy filing triggered a federal investigation.

The case demonstrates not only the Labor Department's unresponsiveness but also the failure of a key element of the department's strategy to safeguard the pension funds of 76 million Americans.

There are more than 870,000 pension plans, yet the Labor Department's Pension and Welfare Benefits Administration has only 200 investigators and auditors who can examine fewer than 1% of the plans a year. So the agency relies on what it calls a "fail-safe" system—accountants, actuaries and financial advisers hired by the pension plans to review their records and investments.

But the Labor Department inspector general's office contends that there are no incentives for accountants and actuaries to report abuses they discover, and the accusations in the Lundberg case seem to back up the assertion. Among those indicted with Lundberg and Sanders on federal conspiracy, embezzlement and mail fraud charges were the actuary for the pension plans, an employee benefits specialist and a financial consultant with a criminal record.

Further, court records show that Lundberg withheld critical information from his outside auditors, Ernst & Whinney. When asked at a court hearing why he did not tell the auditors about one $2-million transaction involving pension fund money, Lundberg replied: "I'd forgotten about it, frankly."

Lundberg and the others have pleaded innocent to the federal charges and to similar state charges. Lundberg's attorney said that neither he nor his client would discuss any of the allegations.

But interviews and thousands of pages of court records show how millions of dollars that 900 workers and retirees thought was safe disappeared in a swirl of complex deals that preceded the bankruptcy of Lundberg Industries.

"It's a pretty worried feeling when you work on a job for 25 years and find your pension has been stolen," said Leo T. Evans, a retired potash worker. "You don't have another 25 years to do it all over again."

Thomas D. Lundberg was described by one acquaintance as a speaks softly and sometimes conceals his shrewdness by pretending to be confused.

He was born in 1934 and grew up in Midlothian, Tex., a small town south of Dallas. An industrial chemist, he also became involved in real estate investments and owned about 10% of two small Texas banks. He developed what Sanders later described as a "cash bind" when the collapse of oil prices and real estate values drove the Texas economy into a depression in the mid-1980s.

In Denver, meanwhile, a big cement and potash company called Ideal Basic Industries was confronting its own cash-flow troubles. In the second half of 1985, the firm defaulted on $300 million in debt and, in a more traditional response to such difficulties, was moving desperately to raise money by selling assets, including its potash mine in Carlsbad, N.M.

Hundreds of miles of tunnels dug by potash miners wind beneath the desert near the southeastern tip of New Mexico, where the bulk of the nation's potash is mined. The product, which comes out of the ground in large lumps, is used widely in the agricultural industry for fertilizer and refined for use in some food and pharmaceutical products.

Lundberg had once bought potash from Ideal Basic for his chemical businesses and one Sunday at a Dallas Cowboys football game, an Ideal Basic salesman told him that the Carlsbad mine and a companion processing plant in Dumas, Tex., were on the block.

As Lundberg discussed the deal in the next few days with Sanders, it appeared to offer the solution to Lundberg's cash-flow problems, according to a letter that the attorney later wrote. Sanders described the deal in that letter as a way for Lundberg to "resolve all of his past financial problems as well as be a stepping stone for future acquisitions."

By Dec. 31, 1985, Lundberg had arranged to buy the operation for $3 million and the assumption of various obligations. Lundberg did not put any money down, and his first payment on the $3 million was not due for a year.

As part of the transaction, Lundberg agreed to pay Ideal Basic 75% of what he got for selling 160,000 tons of potash already mined and in warehouses.

The acquisition also made Lundberg the trustee for three pension plans covering company workers and retirees. According to the letter Lundberg received at the closing session, the plans had more than enough money to cover their obligations to workers. In fact, there was an estimated $1 million extra.

Lundberg testified in a civil suit in 1987 that he intended from the outset to terminate the three pension plans, create a substitute plan and use the surplus for business expenses.

legally if sufficient assets exist to pay off current and future obligations to beneficiaries. Normally, a company ending a plan buys an annuity to cover the obligations and then uses the surplus for other business purposes.

Although the practice is controversial among workers, it is also increasingly common. A new benefit plan must be created and the termination must be approved by the federal Pension Benefit Guaranty Corp., which insures many pension funds and reviews financial records for proposed terminations.

Lundberg, however, did not wait to terminate the plans before dipping into them.

According to the federal indictment, Lundberg and Sanders met on Jan. 15, 1985, with C. David Donaldson, an employee benefits specialist, and Joe Wall, a Nashville, Tenn., businessman, to extract $2 million from one of the pension plans.

It was one of several transactions that the indictment charges constituted a conspiracy by Lundberg, Sanders, Donaldson and two others to embezzle pension funds. The others were Samuel A. Longo, a financial consultant from Malibu and Dallas, and David J. Boatright, an actuary from Nashville. Wall was not accused of any wrongdoing. California records show that Longo was sentenced to prison in a check-writing scheme that resulted in the collapse of Orange Empire National Bank in Anaheim in 1965.

The pension plan transaction was fairly simple, according to the indictment. As pension trustee, Lundberg lent $2 million in pension money to Wall. Then Wall immediately returned the $2 million to Lundberg as a down payment to buy the machinery at the mine from Lundberg for $28 million. Lundberg then agreed to rent the equipment back from Wall for $318,000 a month.

Lundberg has testified that the $2 million was a loan from Wall and was for company operating expenses. But the indictment charges that only $320,000 went to Lundberg Industries; Sanders got $1 million for legal fees, and $443,000 was used to pay some of Lundberg's debts.

According to the charges, Lundberg never paid Wall rent, and the transaction was not reported to the company's auditors. The machinery did not belong to Lundberg anyway. Ideal Basic had a lien on it until Lundberg paid the $3 million he owed for the company.

Another deal cited by the government used pension money to bail Lundberg out of a soured real estate investment.

In March, 1986, Lundberg and a partner paid $3 million for 127 acres of vacant land south of Dallas. By fall, the lender had started to foreclose because the payments had not been made.

In November, Lundberg estab-

PENSIONS: Mine Owner Accused of Taking Millions

Continued from A12

lished a company called 127 Inc., and made it the owner of the 127 acres. A month later, he transferred 100% of the 127 Inc., stock to another company controlled by Lango, according to the indictment.

Lundberg then arranged with the lender to transfer the loan to 127 Inc., and resigned as a director of the corporation, absolving him of the debt. He then authorized two pension fund loans totaling $1.55 million to 127 Inc., and the company used some of the money to bring the payments current on the land.

In another transaction detailed in the indictment, Lundberg reaped an enormous profit by using pension fund money to buy his own stock in Lundberg Industries at a time when the company was insolvent.

According to the indictment, in late 1986 he sold 17 shares of his personal stock in Lundberg Industries to the company for $903,906. As trustee of the pension plans, he then authorized spending $903,905 in pension money to buy the stock from the company.

Lundberg had paid $100 a share for the stock and the pension fund paid $53,170 per share, which was passed on to Lundberg. When the transaction occurred, bankruptcy court records show that Lundberg Industries was insolvent.

The indictment says that Lundberg's use of the pension fund money alarmed his nephew, Gregg Lundberg, who had been brought to Carlsbad from Los Angeles early in 1986 to be comptroller of Lundberg Industries. Gregg Lundberg was an accountant who was attending law school in Los Angeles at the time. His father, Kenneth, a former K mart manager, had been hired as manager of the mining operation.

In November, 1986, according to the indictment and Gregg Lundberg's lawyer, Gregg and his father objected that some uses of pension fund money were inappropriate. To settle the dispute, the indictment said, Tom Lundberg agreed to buy his brother's 40% interest in Lundberg Industries for $600,000. That was 15 times the $40,000 Kenneth had paid for the stock less than a year earlier. The $600,000 came from Lundberg Industries.

The company had been a family affair from the day Lundberg bought it. He brought Kenneth in as general manager and paid him $100,000 and a $150,000 bonus in 1986. Gregg was paid $55,000 and a $50,000 bonus. Tom's wife, Lois, received $100,000 in salary and a bonus.

Lundberg himself collected $125,000 in salary and a $150,000 bonus in 1986. He kept his 4,000-square-foot house near Dallas and penthouse condominium on the Gulf of Mexico and routinely chartered private planes at company expense for trips to the mine in Carlsbad and elsewhere.

In November, 1986, Lundberg had good reason to buy out Kenneth and send Gregg back to California.

He was awaiting the big pension payoff.

In July, he had started the process of terminating the pension plans to obtain the surplus assets. The surplus he anticipated receiving was not the $1 million estimated six months before, but $3.6 million.

Evaluating pension plan assets against obligations is done by actuaries through mathematical tables. Different actuaries often arrive at different results.

Lundberg hired Boatright to evaluate his plans, and Boatright came up with a surplus of $3.6 million. His calculations were submitted to the Pension Benefit Guaranty Corp. and brought a routine approval of the termination.

The federal indictment charged that the calculations were fraudulent because they were based on overvalued pension fund assets and failed to include significant transactions that affected the financial health of the funds.

The indictment also charged that Lundberg Industries never bought the annuities to fund the mandatory substitute plan, which ultimately would leave the federal pension insurance agency with a bill for more than $6.5 million.

On Jan. 5, 1987, a deposit of $3.6 million, representing the surplus, was made in one of Lundberg's business accounts and Lundberg testified that most of the money went into the company's operating account.

Despite the infusion from the pension funds, Lundberg failed to make his required $180,000 payment to Ideal Basic on the $3-million purchase note for the mine. Instead, he sued Ideal Basic in federal court in Albuquerque.

The suit said that Ideal Basic had blocked Lundberg's efforts to obtain permanent financing for the mining operation—and, strangely, that the pension funds had been underfunded when he acquired them.

Paavo T. Tunninen, Ideal Basic's senior vice president, said in an interview that the company

Please see PENSIONS, A14

PENSIONS: Mine Owner Charged

Continued from A13

viewed the lawsuit as a "smoke screen" to allow Lundberg to avoid paying what he owed Ideal Basic, which was far more than $180,000.

According to a countersuit filed by Ideal Basic, the mine's potash inventory was sold by Lundberg in 1986 and Ideal Basic should have been paid $6.4 million as its 75% of the proceeds under the purchase agreement. But Lundberg refused to pay the money.

After filing the lawsuit against Ideal Basic, Lundberg Industries slid steadily toward bankruptcy while the amount that Lundberg took out of the company in salary and other payments rose sharply. Bankruptcy court records show, for instance, that in the 45 days after the company filed for bankruptcy, Lundberg and his wife received $120,412 from the business.

Lundberg was hardly living as someone whose company was on the verge of bankruptcy. In a deposition, he acknowledged paying $55,766 to buy a new Mercedes-Benz for his wife on March 5, 1987. On March 16, he paid $150,000 in cash for a house for his son.

After Lundberg Industries filed for bankruptcy, the mine workers in Carlsbad gathered the signatures for a petition to require the local district attorney to begin a grand jury investigation. The grand jury started in the fall of 1987.

At roughly the same time, the federal judge in the bankruptcy case in Dallas appointed a trustee to take over the operations of Lundberg Industries. The trustee, lawyer David W. Elmquist, discovered that the company was at least $14 million in debt and that the pension funds were almost broke.

Elmquist said in an interview that he did not find any evidence that the Labor Department was aware of the problems with the pensions until after he took over the case and discovered a series of questionable transactions. He notified the Labor Department.

"I don't know, from a practical standpoint, how the Department of Labor or anyone else would police the activities of pension plans and trustees," Elmquist said. "They are just such a ripe area for abuse."

The potash workers and retirees did not lose their pensions. The Pension Benefit Guaranty Corp. stepped in quickly and took over the pensions. And then the Labor Department began an investigation into what happened to the pension fund assets of Lundberg Industries.

Pension Fraud Regulators Run on 'Different Tracks' and a Big Case Folds

By DOUGLAS FRANTZ
TIMES STAFF WRITER

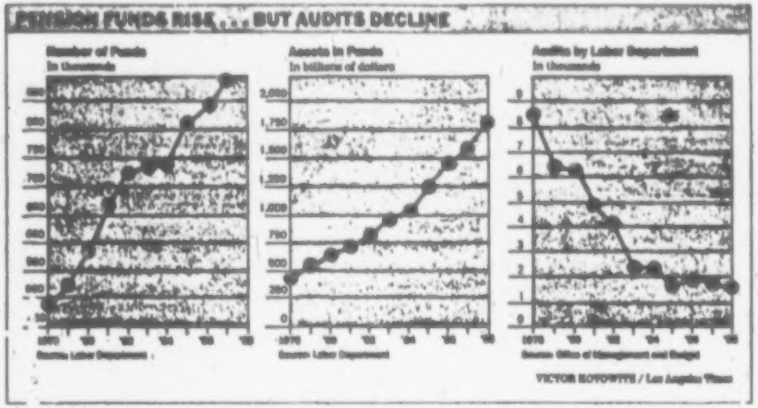
SAN JOSE—The federal government spent two years and $300,000 investigating allegations of pension fraud by the president of a construction company with a contract to build this city's downtown transit mall.

But in the end, the case was damaged by a U.S. Labor Department letter that, according to the top federal prosecutor in Northern California, influenced him to dismiss criminal charges against the executive, David G. Weiss.

The incident illustrates a central conflict in the battle to protect the pension funds of 76 million Americans. Regulators see their first priority as recovering money for beneficiaries, while law enforcement officials want criminal convictions that send a strong message of deterrence.

"These regulators are on a different track," said Joseph P. Russoniello, the U.S. attorney in San Francisco. "They don't understand or fully appreciate how an action can affect the government in trying to make a criminal case. It would be the same as a unit of the Department of Defense saying to a contractor, 'Sure, we know your product is defective,' or, 'You didn't do adequate testing or misappropriated money. But that's OK[illegible]

Charles Lerner, a regulat[illegible] is enforcement director of the Labor Department's pension agency, declined to discuss the Weiss case. But he explained that, although his investigators often cooperate in criminal cases, their first priority is to restore money to pension plans—and civil solutions accomplish that faster.



Source: Labor Department

Source: Labor Department

Source: Office of Management and Budget

VICTOR KOTOWITZ / Los Angeles Times

It was state authorities who first uncovered evidence of possible misuse of pension and health plan funds at Weiss Bros. Construction Co., the main contractor on San Jose's $32-million transit mall.

In January, 1987, workers complained to the district attorney's office about Weiss. The district attorney investigated and charged Weiss in state court in late 1987 with bribing city inspectors in connection with the project. He has pleaded not guilty and is awaiting trial on the state charges.

Federal authorities were brought in because the state investigation uncovered evidence that federal pension laws may have been violated. Weiss Bros.' contract with its employees required the company to maintain pension and health plans for workers on the transit project. But substantial chunks of the money apparently were used to pay company expenses.

The federal investigation, which was supervised by the U.S. attorney's office in San Francisco, also found that David Weiss may have used corporate money for personal purposes, such as making payments on his historic, 7,000-square-foot mansion in Palo Alto.

A prosecutor and two investigators spent two years full-time on the pension aspects of the case. They examined more than 50,000 pages of documents and bank records seized with a search warrant from Weiss Bros. in April, 1987.

"It was very complicated," said Terry Lee, the prosecutor who led the inquiry. "There were transactions in numerous financial institutions across the country. It took forever and ever. It was a very, very interesting puzzle to sort out."

For instance, according to court records, the prosecutors tracked an $85,000 withdrawal from the health plan on April 2, 1986, into a Weiss Bros. business account. From there, the money went to a law firm, which investigators discovered had used the money to pay an unrelated civil judgment against Weiss Bros.

Meanwhile, some initial complaints regarding pension-fund abuses had been passed on to the Labor Department's Pension and Welfare Benefits Administration, which monitors pension funds. While evidence was being assembled in the criminal case, the PWBA took a unilateral step that would have a major impact on the case.

On July 14, 1987, the PWBA area director in San Francisco notified the company that the agency had concluded an investigation of its benefit-fund practices and found that federal laws may have been violated.

The PWBA letter, which is contained in court files in San Jose, said that $305,000 had been transferred improperly out of the health and pension plans, that the company had been $163,000 behind in its payments to the pension plan and that ineligible employees had received pensions.

The PWBA asked the company for a written description of its corrective steps. By this time, however, the company had restored the $305,000 to the health and pension plans—although not until after the investigation started—and the agency said it would not take further action.

"You are strongly cautioned to refrain from such actions in the future," wrote the PWBA area director, Leonard L. Garofalo.

Russoniello, the U.S. attorney, said his office was unaware of the letter for months as the investigators proceeded to piece together the criminal case.

In July, 1988, a federal grand jury indicted Weiss and the company on charges of embezzling $227,000 from the pension and health plans. Weiss also was charged with tax evasion. He faced a lengthy prison term if convicted.

But the government lost the first round. Weiss was tried on the tax charges first, and he was acquitted in March, 1989.

Charles R. Breyer, his lawyer, said the acquittal opened the door for a plea agreement on the embezzlement charges. He felt the acquittal on the tax charges might help show jurors that Weiss was being prosecuted unfairly for acts that were not criminal, particularly when coupled with the PWBA letter.

"Ultimately, I think the letter did have some weight with the U.S. attorney in finally disposing of the case," said Breyer, who described the pension charges as technical transgressions and contended much of the pension money involved would have reverted to Weiss anyway as surplus funds that were not necessary to meet obligations to retirees. Russoniello agreed that the letter affected the outcome.

"The government's case was undermined by the publication of the fact that the agency that had the responsibility for regulating these funds did not see the conduct as outrageous and criminal," he said. "It was a serious impediment to our effort. It made the ultimate disposition that we reached seem favorable or acceptable to the government."

In the resulting plea bargain, all charges against David Weiss were dismissed. The company pleaded guilty to 10 counts of embezzlement and agreed to pay a fine of $100,000 plus $150,000 toward the cost of the investigation. The company and Weiss were barred from state and federal public works contracts for five years.

Terry Lee was disappointed. "As prosecutors, we want to put people in jail," she said. "But when the government agencies are disagreeing with each other or behaving in a different fashion, it damages an investigation."

PENSIONS: CAN FRAUD BE STOPPED?

Florida Restaurant Loan Scheme Goes Sour

By ROBERT L. JACKSON
TIMES STAFF WRITER

MIAMI—Law enforcement authorities say pension-fund officials who have little loyalty to their members are especially vulnerable to the sort of approach that Florida businessman Leonard J. Mercer Jr. used on his friend, Joseph J. Higgins.

Mercer, a Ft. Lauderdale hotel owner, told Higgins that he needed $375,000 to purchase the Ta-Boo, a Palm Beach restaurant.

Higgins had access to that much money and more. He had been retained by New Jersey Teamsters Local 701 to invest $20 million worth of union pension funds in residential and commercial loans.

But Higgins told Mercer that union rules, which were designed to protect members, restricted how Higgins' company, Omni Funding Group Inc., could invest the Teamsters' pension funds. In particular, no funds could be placed in high-risk ventures such as bars, restaurants and bowling alleys.

According to federal court records, Mercer then devised a scheme for Omni Funding to advance him the money under the guise that it would be used to refinance his hotel.

Omni provided the loan and submitted false reports about it to the Teamsters local, which forwarded them to the U.S. Labor Department. In return, Mercer paid $42,500 in kickbacks to Higgins in the form of cash, free hotel suites, meals and other gifts.

Reporting false information about pension-fund loans is a violation of the Employee Retirement Income Security Act, which Congress passed in 1974 to tighten up supervision over pension funds.

Acting on an insider's tip, the Labor Department's Office of Labor Racketeering, in conjunction with the U.S. attorney's office in Miami, launched a criminal investigation into Mercer and Higgins that led to guilty pleas by both men and their eventual imprisonment.

Mercer pleaded guilty to kickback charges as well as perjury for lying to a federal grand jury when he testified that Higgins had paid for his stays at Galt Ocean Mile Hotel, which Mercer owned. Identified by the Pennsylvania Crime Commission as a longtime associate of Philadelphia mob figures, Mercer received four years in prison and a $40,000 fine.

In a separate court appearance, Higgins pleaded guilty to perjury, wire fraud and mail fraud and was sentenced to eight years in prison.

Two trustees and two lawyers for the Teamsters' New Jersey pension fund also were eventually implicated in similar corrupt dealings with Higgins. One of those implicated pleaded guilty and the other three were convicted of racketeering and mail fraud.

And nothing worked out for Mercer. Before he went off to jail last spring, his hotel and restaurant went bankrupt.

LOS ANGELES TIMES

Nest Eggs Left in Employers' Care Bear Watching, Experts Say

By DOUGLAS FRANTZ
TIMES STAFF WRITER

WASHINGTON—Millions of American workers and retirees depend on income that they expect to receive or are receiving from a pension fund. Should they be frightened by stories of abuses and the government's difficulties in monitoring pension plans?

"They need to be alert, not alarmed or terrified," said Karen W. Ferguson, director of the nonprofit Pension Rights Center here. "If they don't look at what's going on with their pension money, maybe nobody is looking."

Indeed, the government's own figures show that fewer than 1% of the nation's 870,000 pension plans are examined every year by the appropriate Labor Department agency. The larger funds must be checked by outside auditors and must file annual reports with the government. Those with fewer than 100 members don't have to have outside audits; they report to the government every three years.

So, Ferguson says, you have to be your own watchdog. That can be a daunting task.

The starting point is the annual financial summary of the plan that your employer or former employer provides. This statement of one or two pages can be a useful indicator of how well the pension fund's investments are faring and may show where the plan has lost significant amounts of money, but it does not tell the whole story.

If you ask in writing, your employer is required to provide you with a copy of the detailed financial report the plan files with the government. This is a Form 5500 or, if the plan has fewer than 100 participants, a Form 5500C.

Understanding this form does not require a degree in accounting if you know the basic laws governing how the pension plan may invest money and if you learn a little about how to read the form.

The law, according to the Pension Rights Center, can be simplified into four rules:

—Pension money must be invested in the interest of the beneficiaries. It may not be used to benefit the people who make the investments or to further the interests of the employer or the union.

—Administrative costs and expenses such as salaries, office rent and travel must be reasonable, and full-time company or union employees may not be paid for managing the fund.

—Investments must be diversified. Fund managers are not permitted to put all of the money into one stock or real estate deal. They have to spread it around so that one bad investment cannot wipe out the fund.

—The managers are required to demonstrate skill and prudence in investing and protecting your money. They are to [illegible] investments that could result in large losses. They cannot avoid risk, but the risks taken should be reasonable.

These rules and a map to understanding Form 5500 are available in a guide published by the Pension Rights Center, a nonprofit organization that works to educate the public about pension issues and to protect the rights of workers and retirees.

The booklet, "Protecting Your Pension Money," may be ordered for $6 from Pension Publications, Box D, Suite 704, 918 16th St. NW, Washington, D.C., 20006.

If you suspect trouble with your pension plan, you may contact the Labor Department Pension and Welfare Benefits Administration, which has its headquarters in Washington and field offices in 14 major cities, including Los Angeles (Room 718, 3660 Wilshire Blvd., Los Angeles, 90010).

Agency officials say that they take complaints seriously, but some people have had problems getting the department's attention. The officials recommend that you accompany your letter with a written summary of the problems you have uncovered, along with supporting documents.

If your employer goes out of business and your plan does not have enough money to meet its obligations, your pension may be taken over by the federal Pension Benefit Guaranty Corp. The agency insures the pensions of about 40 million Americans who have defined-benefit plans, the kind that promise a specific amount of money upon retirement.

Your rights with the PBGC are explained in "Your Pension, Things You Should Know About Your Pension Plan," published by the PBGC and available for $1 from the Superintendent of Documents, Government Printing Office, Washington, D.C., 20402-9325.

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

October 31, 1989

SUBJECT : **Fiduciary Standards and Enforcement of the Employee Retirement Income Security Act (ERISA)**

BACKGROUND

In 1958, Congress passed the Welfare and Pension Plans Disclosure Act (WPPDA), the central theme of which was that adequate disclosure of pension plan finances would be sufficient to maintain the financial integrity of the funds. At that time, assets amounted to less than $50 billion. The WPPDA proved to be ineffective. Subsequent congressional investigations found that pension and welfare benefit funds continued to be diverted for private purposes by the employer or union involved. Congress replaced the inadequate financial reporting requirements of the WPPDA with more detailed and stringent requirements when it passed the Employee Retirement Income Security Act (ERISA) in 1974. By that time, plan assets had increased to about $200 billion. Today, private pension assets are estimated to total $1.6 trillion.

While there is no requirement that employers provide pension plans for their employees, when employers elect to do so, ERISA prescribes who must be covered (participation standards), how long a person has to work to be entitled to a benefit (vesting standards), how much must be set aside annually to fund the benefit obligations (funding standards), how the funds should be invested (fiduciary standards), and what information must be provided to the Government and plan participants (reporting and disclosure requirements).

DEPARTMENT OF LABOR INVESTIGATIVE AND ENFORCEMENT RESPONSIBILITY

Title III of ERISA sets forth the jurisdictional, administrative, and enforcement responsibilities of the law, which are shared by the U.S. Department of Labor (DOL), the Internal Revenue Service (IRS), and the Pension Benefit Guaranty Corporation (PBGC). The IRS ensures compliance with Title II of ERISA, which sets forth the participation, vesting, and funding standards.[1] PBGC, which was established by Title IV of ERISA, deals with the pension benefit insurance provisions. DOL's enforcement efforts primarily focus on the provisions in Title I of ERISA, which deal with the protection of employee benefit rights. Specifically, DOL ensures plan compliance with fiduciary standards. In addition, DOL ensures compliance with audit and disclosure requirements. Within DOL, the Pension and Welfare Benefits Administration (PWBA), Office of Enforcement, is primarily responsible for ERISA investigative and enforcement activities.

In 1978, DOL began following a "significant case" approach to enforcement. This strategy sought to secure the widest scope of enforcement and compliance by focusing on the fiduciary investigations of large plans. This approach necessarily excluded other areas of ERISA enforcement, such as delinquent and deficient annual report filing, criminal investigations, and all enforcement related to small plans. In response to criticism of this approach, DOL redirected its enforcement efforts in 1982 to emphasize criminal enforcement, greater review of small plans, and consideration of nonfiduciary violations. This approach, however, was criticized for its vagueness, inconsistency, and absence of a clearly defined strategy.

The DOL's current ERISA enforcement strategy was implemented in FY 1987. At present, 50 percent of PWBA's investigative resources is devoted to examinations of welfare plan service providers and financial institutions that act as pension plan fiduciaries; the remaining 50 percent is allocated to investigations of individual plans. The DOL has an authorized enforcement staff of 266 employees located at 15 field offices throughout the country.[2]

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[1] When IRS identifies a violation, it can impose several types of sanctions, such as assessing excise taxes and penalties or revoking the plan's tax-qualified status.

[2] U.S. General Accounting Office. *Pension Plans: Labor and IRS Enforcement of the Employee Retirement Income Security Act.* GAO/HRD-89-32, Jan. 1989. Washington, 1989. 18 p. [Hereafter cited as U.S. General Accounting Office, *Pension Plans*]

Investigations

As part of its investigative and enforcement activity, the Secretary of Labor has the power to investigate the reports, books, and records of a plan in order to determine if there have been violations of law. The General Accounting Office (GAO) also may examine any books, documents, papers, records, or other recorded financial information of the plan, as well as persons providing services to the plan.

ERISA FIDUCIARY STANDARDS

The ERISA sets standards for fiduciaries of pension and welfare benefit plans.[3] A fiduciary is a person placed in a position of trust and made liable for a breach of fiduciary responsibility regardless of whether such a breach is from his deeds or those of other fiduciaries (if he has knowledge of such a breach by another fiduciary and fails to take corrective action). For example, plan trustees and, in some cases, investment managers are plan fiduciaries.

Plan fiduciaries must act prudently and solely in the interests of plan participants and beneficiaries. The prudence standard requires that each fiduciary act with care, skill, prudence, and diligence under the circumstances then prevailing and act as a prudent person serving in a like capacity and familiar with such matters would in conducting an enterprise of like character and with like aims.

Diversification of Assets and Limitations on Investments

The ERISA requires fiduciaries to diversify plan assets to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. Factors to be considered include the purpose of the plan, the amount of plan assets, insurance and industrial conditions, and distribution as to geographical location. Generally, no more than 10 percent of the plan assets may be in securities or real property of the employer. (The limitation does not apply to defined contribution plans such as 401(k) and profit-sharing plans.)

Prohibited Transactions

Some transactions between a plan and a party-in-interest to the plan are specifically prohibited. A party-in-interest includes any fiduciary

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[3] A "welfare benefit plan" provides such benefits as health, life, and disability insurance; a "pension plan" provides retirement income or results in the deferral of income.

(administrator, officer, trustee), counsel, or employee of an employee benefit plan; a person providing services to the plan; an employer; a relative of any of the foregoing; or an employee organization any of whose members are covered by the plan.

A prohibited transaction would include the direct or indirect sale, exchange, loan, or leasing of any property between the plan and a party-in-interest. Furthermore, ERISA generally prohibits a fiduciary from dealing with the income or assets of the plan in his own interest or for his own account. The DOL may grant class or individual exemptions for particular transactions pursuant to its rules and regulations.

Annual Report and Opinion of Independent Qualified Public Accountant

Each pension and welfare benefit plan covering 100 or more participants must submit an annual financial report that includes an opinion by an Independent Public Accountant (IPA) on whether the financial statements are presented fairly in conformity with *generally accepted accounting principles*.[4] The examination is to be conducted in accordance with *generally accepted auditing standards*. This examination is to include tests of the books and records of the plan as necessary. The IPA is also required to offer an opinion as to whether the separate schedules required to be included in the annual report are presented fairly when considered in conjunction with the financial statements taken as a whole. These schedules include:

- a statement of the current value of the assets and liabilities compared with the previous year;
- a statement of receipts and disbursements aggregated by general sources and applications;
- a schedule of all assets held for investment purposes aggregated and identified by issuer, borrower, or lessor, or a party-in-interest;
- a schedule of each transaction involving a person known to be a party-in-interest;
- a schedule of all loans or fixed income obligations which were in default; and

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[4] A simplified triennial report has been prescribed for *pension* plans with fewer than 100 participants. For the other 2 years, a shorter form must be filed. An employee *welfare* benefit plan with fewer than 100 participants is generally exempt from the annual reporting and disclosure provisions.

- detailed information on each transaction involving an amount in excess of 3 percent of the plan's assets.

No IPA opinion is required regarding statements prepared by insurance carriers, banks, or similar institutions that are regulated, supervised, or subject to periodic examination by a State or Federal agency.

ERISA VIOLATIONS

The DOL has the primary role in enforcing the fiduciary standards for all pension and welfare benefit plans. Its enforcement authority extends to both civil and criminal matters under Title I, although the authority to litigate is used for enforcement of civil violations only.

Criminal violations are referred to the U.S. Department of Justice. Criminal violations include embezzlement of plan funds, false reporting, or willful violations of reporting and disclosure requirements.

Civil violations involve such issues as failure to abide by the plan's trust agreement or the failure of plan fiduciaries to discharge their duties for the exclusive benefit of plan participants. Other civil violations include late contributions or improper actuarial valuations. The failure to bond persons handling pension funds also constitutes an ERISA violation, as do failures to file the required annual report or to disclose certain material to plan participants and beneficiaries.

When fiduciary violations are identified, DOL may pursue several courses of action. First, DOL may obtain voluntary agreements from plan fiduciaries to correct the violations. Second, it may initiate civil litigation in Federal district court to require plan fiduciaries to correct a fiduciary violation. Third, DOL can refer a violation to the IRS for imposition of an excise tax against the plan. These actions can result in restoration of plan assets, reversal of prohibited transactions, or removal of plan fiduciaries.

A report by GAO in January 1989 found that in FY 1986 and FY 1987, the DOL identified 573 and 574 fiduciary violations, respectively.[6] The GAO report noted that the most common types of violations were prohibited transactions and prudence violations. The value of plan assets restored and transactions reversed as a result of DOL's actions increased from about $42 million in FY 1985 to about $106 million in FY 1987. Through the first 8 months of FY 1988, assets restored and transactions reversed totaled $59 million. (Welfare benefit plans were not covered in the GAO review.)

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[6] U.S. General Accounting Office, *Pension Plans*.

APPWP
Association of Private Pension and Welfare Plans

Howard C. Weizmann
Executive Director

November 17, 1989

The Honorable William J. Hughes
Chairman
Subcommittee on Retirement Income & Employment
House Select Committee on Aging
Room 174, House Annex 1
Washington, D.C. 20515

Attention: Brian Lutz, Staff Director

Dear Mr. Chairman:

The Association of Private Pension and Welfare Plans (APPWP) respectfully submits the enclosed statement for the record for the hearing you conducted on November 15, 1989 entitled, "Who's Minding Your Pension?" The hearing, and our statement, concerns the November 9, 1989 report of the Acting Inspector General of the U.S. Department of Labor, entitled "Changes are Needed in the Employee Retirement Income Security Act (ERISA) Audit Process to Increase Protections for Employee Benefit Plan Participants."

Thank you.

Sincerely,

Howard C. Weizmann
Executive Director

1212 New York Avenue, N.W. • Suite 1250 • Washington, D.C. 20005 • (202) 289-6700 • FAX (202) 289-4582

APPWP
Association of Private Pension and Welfare Plans

Statement For the Hearing Record

The Association of Private Pension and Welfare Plans is pleased to provide this statement for the hearing record with regard to the November 9, 1989 report of the Acting Inspector General (IG) of the U.S. Department of Labor entitled, "Changes are Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants." The APPWP is a nonprofit organization founded in 1967 with the primary goal of protecting and fostering the growth of America's private employee benefit system. The APPWP's members represent large and small employers as well as the leading support organizations to benefit plans: investment firms; banks; insurance companies; and accounting, benefits consulting, and actuarial firms. APPWP members sponsor or provide support services to plans covering tens of millions of American workers.

Charges by the IG in his semiannual report last May have created an uproar across the country. The APPWP decries the IG's overly dramatic comparison of the auditing and reporting problems within the private pension system to the recent notoriety surrounding our savings and loan institutions. This comparison is irresponsible and simply not valid. The statement has caused undue alarm to millions of Americans whose benefits are in fact quite safe and secure.

The APPWP strongly believes that the U.S. private pension system is sound, that almost all sponsors and trustees are committed to serving the best interests of plan participants and their families, that they are steadfast in their efforts to comply with the law, and that the enforcement penalties currently available are effective to deal with instances of fraud or abuse as they are discovered. To the extent that there is insufficient government monitoring or honest confusion as to compliance, alternatives other than dramatic changes in ERISA are available and must be explored.

Since the passage of the Employee Retirement Income Security Act of 1974 (ERISA,) the pension system in the United States has improved to the extent that 80 percent of plans are fully funded in 1988, compared to only 35 percent in 1974. Today, 875,000 private sector employer-sponsored pension plans have assets totalling over $1.4 trillion, funds that represent the lion's share of private savings in the United States. These funds are carefully and wisely invested; pension funds ended 1987 -- the year of the stock market's Black Monday -- losing only 10.4 percent of total assets, compared to an overall market loss of 25 percent. Today, nearly two-thirds of those working at least 2,000 hours per year participate in an employer-sponsored plan. In medium to large firms, 91 percent of employees participate in a defined benefit plan, defined contribution plan, or both. In 1975, only 4.8 million people were receiving benefits; by the year 2000, it is estimated that 13 million will receive such benefits. This record is indeed a tribute to voluntary employer plans and to ERISA.

The APPWP is concerned that the Congress may take precipitous action in response to the IG's report, further hamstringing the private pension system without carefully considering the true dimensions of the problems cited by the IG and without realistically assessing the available remedies for correcting many of the problems uncovered or alleged in this report.

The APPWP strongly believes that no dramatic legislative changes to ERISA or any other statute are required to ameliorate alleged problems uncovered by the IG. ERISA established strict funding and fiduciary guidelines and standards, as well as an enforcement system, all of which have been amended and strengthened over the years. To the extent that independent public accountants' (IPAs) reports and other auditing measures uncover fraud or abuse, ERISA Sections 104(a)(4) and (5), and 502 provide sufficient legal incentives to cure the defect and punish wrongdoers. Moreover, state laws provide adequate criminal sanctions for illegal activities. Perhaps these tools have not been fully utilized because of a lack of resources. However, it is only after they have been fully utilized and found lacking should any alterations of ERISA enforcement provisions be contemplated.

There is always the risk of abuse and mismanagement by trustees; however such cases are indeed few and far between. Trustee banks take very seriously the burden of their fiduciary responsibility. While we would agree that auditing procedures may need to be strengthened, the IG's suggested changes with respect to audit reporting, such as those concerning trustees and the elimination of limited scope audits, could increase such expenses for employers seven-fold. For all plan sponsors, but especially for small employers, this would provide yet another strong disincentive for establishing or maintaining a plan.

Deputizing IPAs, as suggested by the IG, would also have profound and negative repercussions. Requiring IPAs to report every infraction and exposing administrators to criminal proceedings will soon eliminate professional administrators. Again, there are alternatives to help improve the way the current system operates without subjecting plan sponsors to the fear of criminal charges for simple noncompliance, especially because the preponderance of noncompliance results from the fact that pension law has been substantially changed each year in the last decade. Unintentional, technical noncompliance has become an understandable hazard for even honest plan administrators.

Congress and other policy planners must bear in mind that in developing pension policies, two sometimes competing objectives must be met. Serving the best interests of beneficiaries must be balanced with a recognition that overly constraining, complex, and costly so-called solutions will drive more and more employers away from the private pension system. This is a result that serves no public policy goal. We as a nation should be developing policies that will encourage greater expansion, not contraction, of pension coverage. Instead, recent legislative activity in this area has been driven by the need to raise revenues, and has served only to make sponsorship of pension plans a much more risky, costly, and unsatisfying endeavor than it was just ten years ago. As a result, increased coverage under the private system has stagnated.

The APPWP believes that the Department of Labor/PWBA should be permitted to complete its current assessments of its enforcement capabilities, strategies, and resources and, working closely with the Congress, the ERISA Advisory Council, and the American Institute of Certified Public Accountants, develop appropriate and sensitive responses to the IG's report. It is of paramount importance that whatever policy changes are enacted should not only keep the pension promise safe and secure, but help extend that promise to more Americans. If policymakers would strive to keep the rules simple and rational, many problems of compliance would not exist, and more plan sponsors would stay with the pension system.

Howard C. Weizmann
Executive Director
The Association of Private Pension
and Welfare Plans

November 17, 1989

Testimony of

PATRICIA RUTH DONOVAN PETERSEN

DEPUTY INSURANCE COMMISSIONER

STATE OF WASHINGTON

on

REGULATION OF MULTIPLE EMPLOYER WELFARE ARRANGEMENTS BY THE U.S. DEPARTMENT OF LABOR--WASHINGTON STATE'S EXPERIENCE

before the

Select Committee on Aging

Subcommittee on Retirement Income and Employment

U.S. House of Representatives

hearing entitled

Who's Minding Your Pension?

November 15, 1989

Washington, D.C.

Chairman Hughes and members of the Subcommittee on Retirement Income and Employment, on behalf of both Insurance Commissioner Dick Marquardt and myself thank you very much for inviting me to testify before you today.

I am Patricia Petersen. For over five years I have been employed as Deputy Insurance Commissioner for Washington State. In this position I am responsible for issues arising under ERISA which affect state as well as federal jurisdiction. I am an attorney, I have previously practiced business law privately and prior to my current employment I have held a number of state and federal governmental posts.

I regret that my prior commitment does not allow me to attend this hearing in person. Today I am discussing ERISA issues in Eastern Washington with our Governor's Special Assistant for Health and with a group of individuals who operate multiple employer welfare arrangements ("MEWAs") allegedly under the auspices of the Employee Retirement Income Security Act ("ERISA"). Please accept my firm commitment to attend in person your next hearing on these issues.

You have requested me to testify today about Washington State's experience with the U.S. Department of Labor in attempting to regulate MEWAs. I also appreciate the fact that individuals in the U.S. Department of Labor ("DOL") have encouraged your review of its operations and have encouraged my testimony today. This indicates that these individuals, particularly those in the Inspector General's Office of DOL, recognize that there may be areas of its operations which require increased priority.

Accordingly, please consider this statement my formal testimony. This is a very brief summary of this one part of Washington's experience with ERISA. I will be pleased to provide you with an update, further details and any other information you request at your next hearing. In considering federal and state regulation of MEWAs, you are entertaining a major national problem.

MEWAs are a creature of federal law (ERISA). At this time Washington's laws allow only authorized insurers to provide health care coverage to Washington residents. Authorized insurers - which must be commercial disability carriers, health care service contractors or health maintenance organizations licensed by the Insurance Commissioner to provide coverage to residents of Washington - are subject to comprehensive state regulation by the Insurance Commissioner. To protect consumers, the wording and contents of all policies, their rates and their claims handling are continuously monitored, and specific amounts of financial reserves are required to be maintained to ensure that funds are always available to pay claims. Finally, these products must be sold by the carrier or insurance professionals who are licensed by the insurance commissioner. The acts of these agents and of all other representatives of the carrier are also carefully regulated and violations quite frequently result in revocation of licensure or other disciplinary action against agents and carriers.

It was certainly reasonable for Congress to create a new and more flexible method for provision of health care coverage as it did by authorizing MEWAs in ERISA. Groups which assert that they are authorized under ERISA to write health care coverage as MEWAs are abundant in Washington and throughout the nation. There are numbers of longstanding alleged MEWAs which provide coverage tailored to the multiple employer association membership. While these alleged MEWAs are indeed of significant benefit to consumers - who are primarily small employers, their employees and the self-employed - other alleged MEWAs are of mounting concern to states.

Even with the 1983 amendment to ERISA adding Sec. 514(b)(6)(A) and thereby giving substantially more jurisdiction to the states, Washington and the vast majority of states still considered MEWAs a creature of federal law and thus subject to the primary jurisdiction of the U.S. Department of Labor. Therefore, until 1988 Washington State had not imposed state laws to any substantial degree, believing that the U.S. Department of Labor did monitor those groups asserting authority to operate as MEWAs under ERISA. It was only much later, after the injuries described below had occurred, that this state fully realized that in fact 1) ERISA provides very little of the type of consumer protections for MEWAs which state law provides to authorized insurance carriers; 2) in the past and currently the DOL engages in very little monitoring of MEWAs; and 3) the DOL gives almost no support to states in states' activities concerning MEWAs. Further, 4) Washington's experience has shown that even when states uncover evidence of fraud and other crimes the DOL rarely, if at all, takes criminal, civil or other action against those affected MEWAs or the perpetrators.

In 1988 the Insurance Commissioner became aware of Northwest Loggers Association, which was operated and apparently also organized by Mr. Gary N. Stone. Mr. Stone had already had his securities licenses in Oregon and Idaho revoked due to his absconding with clients' funds (he reportedly took funds to the island on Tonga and even now I am advised some of his former securities clients remain unpaid despite two $250,000 judgments against Mr. Stone). Northwest Loggers sold comprehensive health care coverage primarily to loggers and other small businesses in several states ranging from Washington to South Dakota. Northwest Loggers was not an authorized health carrier under any state's laws but instead alleged it was a MEWA subject to the exclusive jurisdiction of the DOL. My office obtained written documentation of fraud and evidence which lead us to believe Mr. Stone was illegally converting corporate funds to his own use. We also obtained evidence of either current or impending insolvency although Mr Stone was continuing to sell the product and operate in an outwardly legitimate fashion. With this evidence of fraud and insolvency, we contacted the DOL, Seattle Regional Office.

In late 1988 the Insurance Commissioner also became aware of Western Business Association, Western Timber Association and Western Alliance of Agriculture, all organized and operated by Mr. Tom J. Hobbs. Mr. Hobbs, who was a former associate of Mr. Stone, acted as President and sole board member of all three companies and also of the companies' third party administrator. Mr. Hobbs asserted that the groups were MEWAs subject to the exclusive jurisdiction of the DOL. We investigated these groups and found evidence which indicated that Mr. Hobbs, while continuing to sell this product, was converting funds belonging to the companies to his personal use. We also obtained written documentation that other fraud was occurring and evidence that the companies were on the brink of insolvency. With this evidence of fraud and insolvency, we contacted the DOL, Seattle Regional Office.

As a result of our call to the DOL regarding both Northwest Loggers and the three Hobbs groups referenced above, I and an investigator from this office met with representatives of the Office of the Inspector General, DOL, who work out of the Seattle Regional Office. We discussed the evidence of fraud and insolvency which this state had procured and we discussed ways of dealing with the problems presented. These representatives indicated that they were already aware of at least some of the problems with Mr. Stone. At the conclusion of our meeting and thereafter, the Office of the Inspector General offered this state no specific help, had no plans for an investigation and had no plans for taking any action against these alleged MEWAs or these individuals. Instead they simply refered me to DOL's Office of Pension, Welfare and Benefit Administration, Seattle Region Office ("PWBA").

Being unable to obtain action from the Seattle employees of the DOL Office of the Inspector General, I telephoned PWBA of DOL, Seattle Regional Office. Through several teleconferences with PWBA, I traced Washington's activities, discussed the evidence we had procured to date against all four companies and I entered my plea to PWBA for its assistance. I made it understood that substantial harm to hundreds of consumers who relied on this health care coverage was imminent. In response to PWBA's request I mailed them a letter dated February 27, 1989 (attached hereto as Exhibit A) detailing the situations regarding all four companies and the individuals involved. As this letter also indicates, PWBA advised me they already knew about problems with Northwest Loggers and Mr. Stone yet had taken no action. At any rate, I included with this letter scores of pages our office had obtained after months of work. These pages were documentation of fraud and imminent insolvency.

Although, as is reflected in my letter (Exhibit A) I was promised action on the part of PWBA, no action or assistance at all was forthcoming. I waited approximately three months. During calls I made to PWBA during this waiting period, the original offers of help became less promising. I was advised by PWBA that its Seattle Regional Office has few employees and handles five states. I was further advised that PWBA Seattle employees have expertise in pension plans and not in ERISA health care arrangements such as MEWAs and that it simply does not have the priority or resources to adequately handle MEWA problems. With that advise, I finally became aware that this state was on its own with regard to intervening in the four alleged MEWAs which were in crisis.

Because of lack of action on the part of DOL, on April 28, 1989 I determined to issue Cease and Desist Orders against these alleged MEWAS, with what legal bases we have available under purely state law. This was in order to prevent further harm to consumers. Prior to the issuance of these Orders (attached hereto as Exhibits B and C), I informed PWBA of my plans. PWBA offered no support except to express pleasure that the state was taking action.

By the time Northwest Loggers received its Cease and Desist Order, it was already insolvent. Mr. Stone immediately departed the state, taking with him an undetermined amount of Northwest Loggers' funds. He also left hundreds of consumers in some six states with thousands - probably hundreds of thousands - of dollars of unpaid medical claims and with no medical coverage. To date I know of no criminal, civil or other disciplinary action taken or planned by any division of DOL or any other entity. I am advised that Mr. Stone has now settled in Nevada, where he is setting up another alleged MEWA.

For the same reasons as with Northwest Loggers, and on the same legal grounds, on May 1, 1989 I issued a Cease and Desist Order against the three Hobbs groups, named above. Mr. Hobbs' attorney responded that the companies would continue to operate in violation of the Order and would not comply with any subpoena of the Insurance Commissioner because, he argued, the Hobbs groups were subject to the exclusive jurisdiction of the DOL and therefore not subject to any state jurisdiction of any kind. A correct reading of ERISA Sec. 514(b), however, proves this argument blatantly incorrect. Accordingly, I again contacted the PWBA Seattle, and in response to my request for help countering this argument I was advised that it could not issue any legal opinion or official statement of any kind and furthermore it could not even make a determination whether a particular group was in fact a MEWA or not. I believe that PWBA in Washington D.C. also indicated then that it would be very difficult to extract an official interpretation of Sec. 514(b) even though the narrow issue was not complicated. PWBA in Washington, D.C. sent copies of opinion letters sent to other states concerning other MEWAs, but in our opinion these letters would be of little weight in court.

In part because of lack of help of PWBA, we could not convince Mr. Hobbs that the state has some jurisdiction in this area, we proceeded to Superior Court to enforce my administrative subpoena. We prevailed and Mr. Hobbs' financial records on their face provided convincing evidence indicating fraud, including indications that he had been converting corporate funds to his personal use. The records also indicated that imminent insolvency was likely. Again I advised PWBA Seattle of these facts. Again, no assistance or action by PWBA was forthcoming.

I have since written to the hundreds of consumers residing in at least three states, advising that they no longer have medical coverage under the Hobbs' companies and that it is not at all certain there are assets enough to pay any claims. After months of effort on the part of this state, an employee of this office is acting as receiver for the three Hobbs companies. The unpaid medical claims, although currently undetermined, easily exceed $100,000. The receiver currently is searching for assets.

In addition to evidence of illegal activities referred to above, this state has also found fairly clear indications of mail fraud. To date PWBA still has taken no criminal, civil or other disciplinary action against Mr. Hobbs or the Hobbs groups. I have been told that DOL's Office the Inspector General may soon, however, now investigate the case. At this late date this will not help the injured consumers, but if DOL does take any action perhaps it will prevent Mr. Hobbs from starting up other alleged MEWAs if he is inclined to do so. Also, perhaps this action is the beginning of a new, more active, approach to be taken by DOL in the future; if so, I hope that PWBA is also involved.

In summary, as a result of our experiences with these four alleged MEWAs, this state has learned that there are almost no federal laws providing protections for the consumer in the MEWA area and there is no visible regulation or enforcement - even for crimes - either before or after a MEWA is formed, is operated, then folds. The vast majority of states - including Washington - have relied on action at the federal level for this creature of federal law rather than regulating MEWAs at the state level.

Again, I wish to thank you for inviting me to testify today and to thank DOL for its encouragement of this testimony. I believe that this encouragement indicates that the DOL wishes to more adequately address the MEWA problems.

Please accept my state's offer of any assistance we can give you. Please also accept my commitment to attend your next hearing and to participate in any way I can. I wish to use my experience in this area to produce beneficial progress. This is an issue of major national importance.

STATE OF WASHINGTON

RICHARD G. (DICK) MARQUARDT
STATE INSURANCE COMMISSIONER

DAVID H. RODGERS
CHIEF DEPUTY

OFFICE OF
INSURANCE COMMISSIONER

REPLY TO
OLYMPIA OFFICE
INSURANCE BUILDING
OLYMPIA WASHINGTON [illegible]
753-7300 AREA CODE 206

February 27, 1989

Charles Blackman, Esq.
U.S. Department of Labor
Pension, Welfare Benefit Administration
901 - 1st Avenue, Room 3135
Seattle, WA 98174

Re: Northwest Loggers Association, Inc. (Spokane) - Gary Stone
Western Alliance of Agriculture (Spokane) - Tom Hobbs
(Attorney is Stuart Polzin)
Western Timber Association (Spokane) - Tom Hobbs
(Attorney is Stuart Polzin)
Western Business Association (Spokane) - Tom Hobbs
(Attorney is Stuart Polzin)

Dear Mr. Blackman:

This letter is pursuant to our recent telephone discussion, and my discussion with John Scanlon during the week of February 6, 1989. During these communications I was advised by your office that while DOL does not specifically certify all qualifying groups as ERISA groups, when you see a problem or potential problem with a group you do examine it and make a specific determination whether or not it is an ERISA group. Then, if it is an ERISA group, or if the group represents that it is an ERISA group, you take action against it.

You understand that the insurance commissioner's office has virtually no jurisdiction when a group is an ERISA group. As a result, the above referenced groups are continually asserting that they are ERISA groups and thereby are 1) denying that the insurance commissioner has any jurisdiction over them, and 2) refusing to cooperate with the insurance commissioner in any meaningful way. I have enclosed the memorandum from our inspector, Mr. Tom Talarico, who is located in the Spokane area. Mr. Talarico has been investigating these groups, to the limited extent he has been allowed, for some time. To supplement his memorandum, Tom has told me that with regard to the three Hobbs groups he believes 1) that there has been inappropriate intermingling of funds between them; 2) that money from the companies is being "siphoned off" by Mr. Hobbs; and 3) that the companies have little or no reserves.

With regard to Northwest Loggers, you advise me that Duane Peterson of your office is in the process of investigating this company. Mr. Talarico's

EXHIBIT A

memorandum also deals with Northwest Loggers. In addition to his statements in this memorandum, Mr. Talarico has advised me 1) that he believes the company is having financial problems (the third party administrator for the company will state that it has problems with Northwest Loggers failing to pay money timely to it so in turn the administrator has to pay claims late); 2) that Gary Stone is conducting the company as an insurance company without a license; 3) that money is being "siphoned off" from the company and taken, e.g. to Tonga; 4) that the security division of this state is also investigating the company and Mr. Stone; and 5) that it is possible that Gary Stone is about to leave town (presumably leaving consumers with little recourse against an entity which has no capital left in it). See, for example, the enclosed copy of a February 2, 1989 article from the Spokane Spokesman Review concerning Gary Stone and Northwest Loggers.

I have enclosed copies of a great deal of material we have collected concerning the above groups. You will see that references to ERISA are made in this material, e.g. Western Business Association's brochure, page 15, concerning "Your rights under the plan (E.R.I.S.A.)" which discusses the fact that "you are entitled to certain rights and protections under the ERISA of 1974," and "If you have any questions on your ERISA rights, contact the ... U.S. Labor Management Service Administration, Dept. of Labor." Further, all of these groups advise this office that they are subject to ERISA and so outside of our state jurisdiction. For example, I enclose October 12, 1988 letter from Stuart K. Polzin, attorney for the Hobbs groups, that the groups (in this letter specifically Western Timber Association) "is a non-profit association set up under federal ERISA guidelines as a self-funded employee benefit association, and therefore, except for transactions the association may enter into with insurance carriers, is not subject to state control." On the basis of the assertion that the Hobbs groups are subject to ERISA, Mr. Talarico informs me that we have been completely unable to look at their books and records or any other pertinent documents.

As we discussed, in our opinion it is imperative that the four groups are immediately examined by your office. We suggest that we send in Mr. Talarico and perhaps a certified public accountant from our office with people from your office. The Commissioner of Insurance from Montana would also like to participate. Should these companies be allowed to continue the way they are--virtually with no restraints, laws or regulations being imposed upon them--we believe the public will be greatly harmed. Further, given that the groups continually claim that they are subject to the jurisdiction of ERISA the public would naturally depend upon DOL to have examined them in light of the apparent problems all these groups are having. I understand that with limited employees in your office you must consider time efficiency, but we in this office are certain that your time spent examining these groups (in concert with our office) would be exceedingly well spent.

Finally, we would also certainly appreciate your making a determination regarding whether the Chelan Valley Business and Health Alliance, formed 1986 or 1987 as a non-profit association and administered by Van Maarth/Maatox (Bob Van Maarth used to be an administrator of Northwest Loggers Association) of 2750 Crabapple Road, Golden, Colorado 80401. Although we currently see few specific problems with this group, a determination in the immediate future is appropriate. This group is very compliant and desires to continue expanding; because neither we nor they know whether they come under ERISA. It appears unfair to deny them the right to expand based upon state law which may or may not in fact apply. If they do not come under ERISA, they will most likely have to shut down as they are not in compliance with state laws.

In closing, we know of no other groups concerning which we believe we need immediate DOL examination. These groups have for some time been blatant sore spots in our array of companies and reaching determinations on them would benefit many many consumers as well as both your office and the insurance commissioner's office. We commit to conduct examinations of these groups with you and look forward to a mutually beneficial working relationship. In this regard, I will telephone you on March 6, 1989 to discuss times to examine these groups.

Very truly yours,

DICK MARQUARDT
Insurance Commissioner

Patricia D. Petersen

PATRICIA D. PETERSEN
Deputy Insurance Commissioner

Enclosures

cc: Don Cofer, Assistant Attorney General
Tom Talarico, Investigator
Shirley Polzin, Chief Investigator

Bob Post, Investigator
Commissioner of Insurance
State of Montana

RICHARD G. (DICK) MARQUARDT
STATE INSURANCE COMMISSIONER

DAVID H. RODGERS
CHIEF DEPUTY

STATE OF WASHINGTON

OFFICE OF
INSURANCE COMMISSIONER

REPLY TO
OLYMPIA OFFICE
INSURANCE BUILDING
OLYMPIA, WASHINGTON 98504-0321
753-7300, AREA CODE 206

In the Matter of)
) NO. D 89 - 60
NORTHWEST LOGGERS ASSOCIATION, INC.,)
) CEASE AND DESIST ORDER
an Unlicensed Entity,)
)
S & S ENTERPRISES, INC.,)
)
an Unlicensed Entity,)
)
and GARY N. STONE,)
)
Licensee.)

To: Northwest Loggers Association, Inc.
P.O. Box 141416
Spokane, WA 99214

To: S & S Enterprises, Inc.
P.O. Box 141416
Spokane, WA 99214

And to: Gary N. Stone
P.O. Box 141416
Spokane, WA 99214

Northwest Loggers Association, Inc. (hereinafter "Northwest Loggers"), an Idaho corporation, S & S Enterprises, Inc. (hereinafter "S & S"), a Washington corporation, and Gary N. Stone, who is the president of both companies and who is an insurance agent duly licensed in Washington State, have been and are currently engaging in activities which are in violation of the Washington State insurance code.

First, Northwest Loggers and S & S have been and/or currently are entering into insurance contracts with residents of the state of Washington and with entities which are headquartered in the state of Washington. RCW 48.05.030 provides that no person shall act as an insurer and no insurer shall transact insurance in this state other than as authorized by a certificate of authority issued to it by the Washington State insurance commissioner. RCW 48.01.050 defines "insurer" to include every person who, among other

EXHIBIT B

activities, engages in the business of making contracts of insurance. Neither Northwest Loggers nor S & S has been issued a Washington certificate of authority pursuant to RCW 48.05.030 or pursuant to any other section of the insurance code. Northwest Loggers and S & S are in violation of RCW 48.05.030 in that they are transacting insurance in Washington State without a certificate of authority issued by the Washington State insurance commissioner.

Second, Northwest Loggers and S & S have been and/or currently are soliciting for insurance in Washington State. RCW 48.17.060 provides that no person shall in this state solicit for insurance without holding a valid license as an insurance agent, solicitor or broker issued by the Washington State insurance commissioner. Neither Northwest Loggers nor S & S has been issued a Washington license as an insurance agent, solicitor or broker. Northwest Loggers and S & S are in violation of RCW 48.17.060 in that they are soliciting for insurance in Washington State without being licensed by the Washington State insurance commissioner as insurance agents, brokers or solicitors.

It should be noted that the state of Oregon issued a cease and desist order against Northwest Loggers, S & S and Gary N. Stone based upon the same or very similar facts which are the bases for the action taken herein. After challenge by Northwest Loggers, S & S and Gary N. Stone on many grounds, including an argument of ERISA preemption, the Oregon cease and desist order was upheld. The state of Idaho also issued a cease and desist order against Northwest Loggers based upon the same or very similar facts which are the bases for the action taken herein. Northwest Loggers did not challenge the Idaho cease and desist order. Further, the insurance agent's license of Gary N. Stone was revoked by the state of Idaho for his involvement in allowing Northwest Loggers to operate as an insurer without a proper license; this revocation went unchallenged.

PURSUANT TO THE FOREGOING, IT IS HEREBY ORDERED:

1. Northwest Loggers Association, Inc., S & S Enterprises, Inc. and Gary N. Stone shall immediately cease and desist from entering into insurance contracts involving individuals and/or entities residing or headquartered in the state of Washington.

2. Northwest Loggers Association, Inc. and S & S Enterprises, Inc. shall immediately cease and desist from the solicitation of insurance in the state of Washington.

3. Gary N. Stone shall immediately cease and desist from the solicitation of insurance provided by insurers not authorized to transact insurance in the state of Washington.

4. Northwest Loggers Association, Inc., S & S Enterprises, Inc. and Gary N. Stone, and any and all affiliates of Northwest Loggers Association, Inc. and S & S Enterprises, Inc. and/or Gary N. Stone shall also immediately cease and desist from all activities which constitute violations of the Washington State insurance code, Chapter 48 of the Revised Code of Washington.

5. Any and all affiliates of Northwest Loggers Association, Inc., S & S Enterprises, Inc. and/or Gary N. Stone shall immediately cease and desist from the solicitation of insurance to, and from entering into insurance contracts with, individuals and/or entities residing or headquartered in the state of Washington unless such affiliates are properly licensed by the Washington State insurance commissioner to solicit such insurance and unless the insurance is properly authorized by the Washington State insurance commissioner.

6. Gary N. Stone shall immediately furnish the Washington State insurance commissioner with a complete list of all entities with which he is affiliated which are engaged in any insurance related activity involving any individuals and/or entities residing or headquartered in Washington and shall detail the particular activities in which each is engaged.

7. Gary N. Stone, as an insurance agent licensed by the Washington State insurance commissioner and as president of Northwest Loggers Association, Inc. and S & S Enterprises, Inc., shall immediately furnish the Washington State insurance commissioner with a detailed explanation of why he (and any affiliates) has been allowing Northwest Loggers Association, Inc. and S & S Enterprises, Inc. to engage in the activities at issue herein, how he intends to remedy the violations outlined above and how he intends to honor valid claims of all covered persons.

8. This Order shall be mailed to Northwest Loggers Association, Inc., to S & S Enterprises, Inc. and to Gary N. Stone by registered mail with return receipt requested. This Order is effective immediately.

ISSUED AT OLYMPIA, WASHINGTON, this [illegible]8th day of April, 1989.

DICK MARQUARDT
Insurance Commissioner

BY:

DAVID H. RODGERS
Chief Deputy Insurance Commissioner

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STATE OF WASHINGTON

RICHARD G. (DICK) MARQUARDT
STATE INSURANCE COMMISSIONER

DAVID H. RODGERS
CHIEF DEPUTY

REPLY TO
OLYMPIA OFFICE
INSURANCE BUILDING
OLYMPIA, WASHINGTON 98504-0321
753-7300. AREA CODE 206

OFFICE OF
INSURANCE COMMISSIONER

In the Matter of)
)
Western Alliance of Agriculture,) NO. D 89 - 62
)
Former Licensee,)
) CEASE AND DESIST ORDER
Western Timber Association,)
)
Licensee,)
)
Western Business Association,)
)
an Unlicensed Entity,)
)
and Tom J. Hobbs,)
)
Licensee.)

TO: Western Alliance of Agriculture
P.O. Box 43
Spokane, Washington 99210

AND TO: Western Timber Association
P.O. Box 43
Spokane, Washington 99210

AND TO: Western Business Association
P.O. Box 43
Spokane, Washington 99210

AND TO: Tom J. Hobbs
P. O. Box 43
Spokane, Washington 99210

Western Alliance of Agriculture (hereinafter "Western Alliance"), is a Washington corporation which has been duly licensed by the Washington State insurance commissioner as an insurance agent for life, disability, property and casualty insurance. Western Alliance has, however, failed to renew its license and so such license has lapsed as of March 3, 1989. Further, Western Alliance has never had any appointments to represent insurers in Washington State.

EXHIBIT C

Western Timber Association (hereinafter "Western Timber"), is a Washington corporation which is duly licensed by the Washington State insurance commissioner as an insurance agent for life, disability, property and casualty insurance. Western Timber holds only one appointment; this appointment gives it the authority to represent Western Vision Services.

Western Business Association (hereinafter "Western Business"), is a Washington corporation and is an unlicensed entity.

Tom J. Hobbs is the President of all three companies and is an individual who is duly licensed by the Washington State insurance commissioner as an insurance agent for life, disability, property and casualty insurance.

Western Alliance, Western Timber, Western Business and Tom J. Hobbs have been and/or are currently engaging in activities which are in violation of the Washington State insurance code.

First, Western Alliance, Western Timber and Western Business have been and/or currently are entering into insurance contracts with residents of the state of Washington and with entities which are headquartered in the state of Washington. RCW 48.05.030 provides that no person shall act as an insurer and no insurer shall transact insurance in this state other than as authorized by a certificate of authority issued to it by the Washington State insurance commissioner. RCW 48.01.050 defines "insurer" to include every person who, among other activities, engages in the business of making contracts of insurance. Neither Western Alliance, Western Timber nor Western Business has been issued a Washington certificate of authority pursuant to RCW 48.05.030 or pursuant to any other section of the insurance code. Western Alliance, Western Timber and Western Business are in violation of RCW 48.05.030 in that they are transacting insurance in Washington State without a certificate of authority issued by the Washington State insurance commissioner.

Second, Western Alliance and Western Business have been and/or currently are soliciting for insurance in Washington State. RCW 48.17.060 provides that no person shall in this state solicit for insurance without holding a valid license as an insurance agent, solicitor or broker issued by the Washington State insurance commissioner. Neither Western Alliance nor Western Business has been issued a Washington license as an insurance agent, solicitor or broker. Western Alliance and Western Business are in violation of RCW 48.17.060 in that they are soliciting for insurance in Washington state without being duly licensed by the Washington insurance commissioner as insurance agents, brokers or solicitors.

It should be noted that the state of Oregon issued a cease and desist order against Western Timber and Tom J. Hobbs based upon facts the same or very similar to those which are the bases for the action taken herein. Neither Western Timber nor Tom J. Hobbs challenged the Oregon order.

PURSUANT TO RCW 48.02.080 AND THE FOREGOING, IT IS HEREBY ORDERED:

1. Western Alliance, Western Timber, Western Business and Tom J. Hobbs shall immediately cease and desist from entering into insurance contracts involving individuals and/or entities residing or headquartered in the state of Washington.

2. Western Alliance and Western Business Association shall immediately cease and desist from the solicitation of insurance in the state of Washington.

3. Western Timber and Tom J. Hobbs shall immediately cease and desist from the solicitation of insurance provided by insurers not authorized to transact insurance in the state of Washington.

4. Western Alliance, Western Timber, Western Business, Tom J. Hobbs and any and all affiliates of Western Alliance, Western Timber, Western Business and/or Tom J. Hobbs shall immediately cease and desist from all activities which constitute violations of the Washington State insurance code (Title 48 Revised Code of Washington) or which constitute violations of the Washington State insurance regulations (Title 284 Washington Administrative Code).

5. Any and all affiliates of Western Alliance, Western Timber, Western Business and/or Tom J. Hobbs shall immediately cease and desist from the solicitation of insurance to, and from entering into insurance contracts with, individuals and/or entities residing or headquartered in the state of Washington unless such affiliates are properly licensed by the Washington State insurance commissioner to solicit such insurance and unless the insurance is properly authorized by the Washington State insurance commissioner.

6. Western Timber, a licensed insurance agent in the state of Washington, and Tom J. Hobbs, a licensed insurance agent in the state of Washington and President of Western Alliance, Western Timber and Western Business, shall immediately furnish the Washington State insurance commissioner with a complete list of all entities with which they are affiliated which are engaged in any insurance related activity involving any individuals and/or

entities residing or headquartered in Washington and shall detail the particular activities in which each is engaged.

7. Tom J. Hobbs, a licensed insurance agent in the state of Washington and President of Western Alliance, Western Timber and Western Business, shall immediately furnish the Washington State insurance commissioner with a detailed explanation of why he (and any of his affiliates) have been allowing Western Alliance, Western Timber and Western Business to engage in the activities at issue herein, how he intends to remedy the violations outlined above and how he intends to honor valid claims of all covered persons.

8. This Order shall be mailed to Western Alliance of Agriculture, Western Timber Association and to Tom J. Hobbs at the most current addresses stated on their licensing documents and to Western Business Association at the last address known to the insurance commissioner. This Order is effective immediately.

ISSUED AT OLYMPIA, WASHINGTON, this 1st day of May, 1989.

DICK MARQUARDT
Insurance Commissioner

By

PATRICIA D. PETERSEN
Deputy Insurance Commissioner